TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1942

No. 552

INTERSTATE TRANSIT LINES, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE

WELL OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT
OF APPEALS FOR THE EIGHTH CIRCUIT

SUPREME COURT OF THE UNITED STATES OCTOBER TERM, 1942

No. 552

INTERSTATE TRANSIT LINES, PETITIONER,

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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[fol. a]

[Caption omitted]

[fol. 1]

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 101692

UNITED STATES BOARD OF TAX APPEALS, INTERSTATE TRANSIT LINES, Petitioner,

VS.

COMMISSIONER OF INTERNAL REVENUE, Respondent

ORDER EXTENDING TIME TO FILE RECORD TO APRIL 25, 1942

Upon motion of counsel for petitioner and consent of

counsel for the respondent, it is

Ordered that the time for preparation of the evidence and transmission and delivery of the record sur petition for review of the above entitled proceeding in the United States Circuit Court of Appeals for the Eighth Circuit be and it is hereby extended to April 25, 1942.

J. E. Murdock, Member.

Dated: January 17, 1942. Washington, D. C.

[File endorsement omitted]

Before United States Board of Tax Appeals

[Title omitted]

DOCKET ENTRIES

Appearances:

For Taxpayer: Henry W. Clark, Esq., Harry J. Gerrity, Joseph F. Mann, Esq.

For Comm'r: Henry C. Clark, Esq.

[fol. 2] 1940

Mar. 8—Petition received and filed. Taxpayer notified. (Fee paid).

Mar. 8-Copy of petition served on General Counsel.

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1940

Mar. 8—Request for circuit hearing in New York, New York, filed by taxpayer. 3/8/40 copy served.

Mar. 25—Motion to consolidate with docket 101693 filed by taxpayer.

Apr. 6-Answer filed by General Counsel.

Apr. 6—Request for circuit hearing in Omaha, Nebraska filed by General Counsel. 4/16/40 Denied.

Apr. 17—Request for circuit hearing in New York City filed by taxpayer. Granted.

Oct. 25-Hearing set Jan. 6, 1941, New York City.

Oct. 25-Hearing set Jan. 6, 1941, New York City on motion.

1941

Jan. 21—Hearing had before Mr. Leech on the merits. Submitted. On motion of petitioner to withdraw previous motion to consolidate with 101693, granted. (Separate Hearings). Appearance of Joseph F. Mann, Esq., and stipulation of Facts filed. Motion to withdraw previous motion to consolidate with 101693, filed at hearing. Petitioner's brief due March 6, 1941; Respondent's brief due 4/17/41; Petitioner's reply brief due 5/8/41.

Jan. 27-Transcript of hearing Jan. 21, 1941 filed.

Mar. 6—Brief filed by taxpayer. 3/6/41 copy served on General Counsel.

Apr. 17-Brief filed by General Counsel.

May 14—Motion for leave to file the attached reply brief, reply brief lodged, filed by taxpayer.

May 16—Copy of motion and reply brief served on General .
Counsel.

July 9—Findings of fact and opinion rendered, Mr. Leech, Div. 6. Decision will be entered for the respondent. 7/9/41 copy served.

July 9-Decision entered, J. Russell Leech, Div. 6.

[fol. 3] Aug. 7—Motion for reconsideration of findings of fact and opinion filed by taxpayer. 9/3/41 Denied.

Nov. 26—Petition for review by United States Circuit Court of Appeals, Eighth Circuit, with assignments of error filed by taxpayer.

Nov. 26-Proof of service of petition for review filed by

taxpayer.

1942

Jan. 17-Agreed motion for extension to 4/25/42 to prepare, transmit and deliver the record, filed.

Jan. 17—Order enlarging time to April 25, 1942 to prepare, transmit and deliver the record, entered.

Feb. 2-Agreed statement of evidence lodged.

Feb. 2—Præcipe for record filed by taxpayer—with proof of service thereon.

Feb. 4—Agreed statement of evidence approved and ordered filed.

BEFORE UNITED STATES BOARD OF TAX APPEALS

Peririon-Filed March 8, 1940

The above named Interstate Transit Lines, petitioner, hereby petitions for a redetermination of its income tax liability and of the deficiency for the year 1936 found by the Commissioner of Internal Revenue, respondent, in his deficiency letter addressed to petitioner, designated SN-IT-1, dated December 13, 1939.

I

Petitioner

The petitioner herein was in 1936, and still is, a corporation of the State of Nebraska, with its executive office at 2116 Leavenworth Street, Omaha, Nebraska. For purposes of this proceeding, however, petitioner's address is C/o [fol. 4] Union Pacific Railroad Company, 120 Broadway, New York City, N. Y.

II

Deficiency Letter

On December 13, 1939, respondent mailed to petitioner a letter dated said day (a copy of which is hereto annexed, together with the supporting statement which accompanied it, marked Exhibit A), which letter is hereinafter referred to as the "deficiency letter".

III

Deficiency Found

The additional tax proposed by the deficiency letter for the calendar year 1936 is \$4,461.53. The amount in controversy for said year is \$3,923.03. 8

Assignments of Error

Petitioner asserts that in the redetermination of its income tax liability for the year 1936, as set forth in the deficiency letter, respondent has erred in the following particulars:

A. In not allowing as a deduction a payment made by petitioner to a wholly-owned subsidiary, Union Pacific Stages of California, which payment, the amount of the deficit incurred by the subsidiary in its operations for the year 1936, was made pursuant to the terms of a valid contract.

V

Facts

The facts upon which petitioner relies in support of the foregoing assignments of error are as follows:

- 1. The petitioner is a corporation organized and existing under the laws of the State of Nebraska.
- 2. Petitioner during the year 1936 was, and still is, engaged, together with two wholly owned subsidiary com[fol. 5] panies hereinafter mentioned, in the operation of motor buses for the transportation of passengers as a common carrier subject to the Motor Carrier Act of 1935 (49 Stat. 543) over various routes between Chicago, Illinois, and Los Angeles, California.

A-Union Pacific Stages of California

Operating Loss

- 3. In the year 1932 and continuing through 1936, the California Statutes (Public Utilities Act, Section 50 1/4, Deering's General Laws of California, Act 6386, page 3161) provided:
- "No passenger stage corporation shall hereafter operate or cause to be operated any passenger stage over any public highway in this state without first having obtained from the railroad commission a certificate declaring that public convenience and necessity require such operation, "."

During such period the Railroad Commission of California refused to grant such certificate of public convenience and necessity except to corporations organized and existing under the laws of the State of California.

- 4. In order to be able to do an intrastate business in California which would supplement its interstate business, petitioner caused the Union Pacific Stages of California (hereinafter referred to as the "Stage Company") to be organized under the laws of the State of California as a wholly-owned subsidiary, and since 1932 petitioner's California business, both intrastate and interstate, has been conducted by the Stage Company and petitioner has done no business in California.
- 5. To insure the uninterrupted transportation of its interstate passengers to and from points in California, petitioner, effective February 7, 1932, entered into an agreement with the Stage Company, a copy of which is [annexted] hereto and marked Exhibit B, under which, among other things, the Stage Company agreed to operate buses upon such routes and upon such schedules and under such operating rules and regulations as petitioner might direct, and in consideration therefor petitioner agreed to assume, and to reimburse the Stage Company for, any deficits incurred by [fol. 6] it in its operations and the Stage Company agreed to pay the petitioner any profits resulting from its operations.
- 6. In order to insure further the uninterrupted transportation of its interstate passengers to and from points in California, petitioner, under date of February 8, 1932, entered into an agreement with the Stage Company, a copy of which is annexed hereto, marked Exhibit C, which provided, among other things, that the buses of each company would operate through on their respective runs beyond the California state line but that at the state line the buses would pass into the custody and possession of the other company and that the employees would become the employees of the company having the custody and control.
- 7. During the year 1936, the deficit incurred by the Stage Company in its operations amounted to \$28,100.66.
- 8. Pursuant to the terms of said contract of February 7, 1932, Exhibit B hereto, petitioner became obligated to pay and did pay to the Stage Company in 1936 said sum of \$28,100.66.

9. The accounts of both petitioner and the Stage Company were, for 1936 and prior years, kept upon an accrual basis.

VI

Relief Prayed

Petitioner prays that its income tax liability for the year 1936 be redetermined by this Board upon the several errors herein assigned and the facts pleaded in support thereof.

Wherefore, petitioner prays that this Board hear and determine its tax liability upon the issues herein set forth. Dated March 5, 1940.

Henry W. Clark, 120 Broadway, New York City, N. Y.; Harry J. Gerrity, Hill Building, Washington, D. C., Counsel for Petitioner.

[fol. 7] Duly sworn to by J. L. Haugh. Jurat omitted in printing.

For Exhibits "B" & "C" see Exhibits 1 & 2 attached to Statement of Evidence.

EXHIBIT A TO PETITION

SN-IT-1

Treasury Department Internal Revenue Service Omaha, Nebraska

December 13, 1939.

Omaha Division 676 Saunders-Kennedy Building

Interstate Transit Lines, 2116 Leavenworth Street, Omaha, Nebraska.

SIRS:

You are advised that the determination of your income tax liability for the taxable year(s) ended December 31,

1936 discloses a deficiency of \$4,461.53 as shown in the statement attached.

[fol. 8] In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to Internal Revenue Agent in Charge, Omaha, Nebraska for the attention of LLN:90D. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully, Guy T. Helvering, Commissioner, by T. P. Smith, Internal Revenue Agent in Charge.

Enclosures: Statement. Form of waiver.

Statement

Interstate Transit Lines, 2116 Leavenworth Street, Omaha, Nebraska

Tax Liability for the Taxable Year Ended December 31, 1936

Income Tax Liability Assessed Deficiency \$83,209.78 \$78,748.25 \$4,461.53

Explanation of Adjustments

(b) The amount of \$28,100.66 claimed as a deduction under Item 25(c) of your income and excess-profits tax [fol. 9] return as "Loss of Wholly Owned Subsidiary Union

Pacific Stages of California Absorbed under Contract" is disallowed for the reason that no provision of the Revenue Act of 1936 authorizes such a deduction.

Computation of Tax

Income tax:	
Normal tax:	
Net income for normal tax computation	\$585,078.99
Less: Interest on U. S. obligations	
Normal tax net income	\$562,465.17
8% of \$ 2,000.00 (Over 0 to \$ 2,000)	\$ 160.00
11% of \$13,000.00 (Over \$ 2,000 to \$15,000)	1,430.00
13% of \$25,000.00 (Over \$15,000 to \$40,000)	3,250.00
15% of 522,465.17 (Over \$40,000)	78,369.78
Total normal tax	\$ 83,209.78
Total surtax	
Total tax assessable	\$ 83,209.78
Income tax assessed (Normal tax and surtax): Original, account No. 400566	78,748.25
Deficiency of income tax	\$ 4,461.53

FOR EXHIBITS "B" AND "C" SEE EXHIBITS 1 AND 2 ATTACHED TO STATEMENT OF EVIDENCE

EXHIBIT D TO PETITION

This Agreement made as of the seventh day of February, 1932, by and between Interstate Transit Lines, a corporation organized and existing under the laws of the State of Nebraska, (hereinafter called Transit Lines), party of the first part, and Interstate Transit Lines, Inc., a corporation organized and existing under the laws of the State of Illinois, (hereinafter called the Illinois Corporation), party of the second part,

Witnesseth .

Recitals: The Illinois Corporation is a subsidiary of, and all of its capital stock is owned by, Transit Lines. [fol. 10] Transit Lines operates busses between various points but operates no busses within the State of Illinois. The Illinois Corporation operates busses in the State of Illinois and also to Milwaukee, Wisconsin. The Illinois Corporation is maintained as an operating subsidiary of Transit Lines and its operations are conducted solely for the benefit of Transit Lines. In order that Transit Lines may obtain the greatest benefit from the operations of the Illinois Corporation it is necessary that the schedules of the Illinois Corporation be coordinated with the schedules of Transit Lines, and that the Illinois Corporation operate on such routes and upon such schedules as will most greatly benefit Transit Lines. Since such operation may not be so remunerative to the Illinois Corporation as operation solely for its own corporate benefit, the parties hereto have agreed that during the term of this agreement such coordinated bus operation shall be carried on under the terms and conditions hereinafter set out.

Now, therefore, the parties hereto mutually agree as

follows:

First. The Illinois Corporation agrees to operate busses upon such routes and upon such schedules, and under such operating rules and regulations, as may be directed by Transit Lines.

Second. Transit Lines agrees to assume and to reimburse the Illinois Corporation for any deficits incurred by the Illinois Corporation in its operations. The Illinois Corporation agrees to pay over to Transit Lines any profits resulting to the Illinois Corporation from its operations. Payments hereunder shall be made only at the end of each calendar year. The deficit or profit, however, shall be calculated for each calendar month separately.

Third. This agreement shall be effective as of the seventh day of February, 1932, and shall continue in full force and effect until terminated by notice as herein provided. Either party hereto may terminate this agreement on the last day of any calendar month by notice delivered on or before that day to the other party hereto.

In Witness Whereof the parties hereto have caused this [fol. 11] agreement to be executed by their respective officers thereunto duly authorized, and under their respective corporate seals, as of the date first above written.

Interstate Transit Lines, by R. J. Walsh, President.

Witness: A. C. Phillips.

Attest: C. B. Matthai, Secretary.

Interstate Transit Lines, Inc., by R. J. Walsh, President.

Witness: A. C. Phillips.

Attest: C. B. Matthai, Secretary.

EXHIBIT E TO PETITION

This Agreement, made and entered into this seventh day of February, 1932, by and between Interstate Transit Lines, a corporation of the State of Nebraska (hereinafter called "Nebraska Company"), party of the first part, and Interstate Transit Lines, Inc., a corporation of the State of Illinois (hereinafter called "Illinois Company"), party of the second part, Witnesseth:

Recitals:

The Nebraska Company has been operating a passenger motor coach transportation business from points west, north and south of Omaha, Nebraska, through Omaha and through the States of Iowa and Illinois, to Chicago, Illinois, and from Chicago to Milwaukee, Wisconsin, doing only an interstate business in the State of Illinois. The Illinois Company, a subsidiary of the Nebraska Company, con-[fol. 12] templates engaging in certain intrastate motor coach operations in the latter state and it has been arranged between the parties hereto that the Illinois Company, in addition to performing said intrastate operations, will take over as successor of the Nebraska Company all motor coach operations heretofore performed by the Nebraska Company in the State of Illinois and in Wisconsin to Milwaukee. The Nebraska Company will therefore terminate its motor coach operations at the Mississippi River and there connect with the motor coach lines of the Illinois Company. For convenience and economy of operation it is desirable that the buses of each party, except buses engaged in operations

local to its territory, run through from its territory into the territory of the other party. The Illinois Company may need, for operations local to its territory, buses in addition to those owned by it and the Nebraska Company is willing to furnish such additional buses on the terms hereinafter stated.

Agreement:

Now Therefore, it is mutually agreed by and between the parties hereto as follows:

Section 1. The buses of the Nebraska Company operating from points west of the Misissippi River (except those engaged in operations local to its territory) shall on each trip continue through east of said river, and at said river shall pass into the custody and possession of the Illinois Company. The buses of the Illinois Company operating from points east of said river (except those engaged in operations local to its territory) shall continue through west of said river, and shall pass into the custody and possession of the Nebraska Company at said river. Each party shall during the term of this agreement, and hereby does, lease its buses to the other party while so in the custody and possession of such other party, subject to the terms and conditions hereinafter stated.

[fol. 13] The Nebraska Company agrees to lease to the Illinois Company, subject to the terms and conditions hereinafter stated, such buses as the Illinois Company may need, in addition to those owned by it, for operations local to the latter's territory, and such buses shall, if and when furnished to the Illinois Company, automatically come under this agreement and be subject to the terms and conditions hereof.

Section 2. The owning party is hereinafter for convenience designated as the "Lessor" and the party to which said buses are leased is hereinafter designated as the "Lessee". The Lessee shall pay to the Lessor monthly a sum of money equal to Five Cents (5c) for each and every mile run by each bus of the Lessor while in the custody and possession of the Lessee. The Lessee shall bear and pay that portion of the expenses of maintaining and operating said buses (other than drivers' wages and taxes) and of insurance thereon, including fire, public liability and property damage, which is properly attributable to

said buses while in its possession. The drivers of buses involved in this agreement shall be the sole employes of, and their wages shall be paid by, the Lessee while such drivers are in service in connection with leased buses in the custody and possession of the Lessee. Each party shall pay taxes on its own buses. Adjustment of accounts as between the parties hereto shall be made monthly as soon after the first of each month as practicable.

Section 3. The Lessee shall be responsible to the Lessor for the buses of the Lessor while in the Lessee's custody and possession.

Section 4. This agreement shall take effect on the date first herein written and shall continue in full force and effect until terminated by written notice given by either party hereto to the other on any date in such notice stated, not less, however, than thirty (30) days subsequent to the date on which such notice shall be given.

[fol. 14] In witness whereof, the parties hereto have caused this agreement to be executed in duplicate as of the date first herein written.

Interstate Transit Lines, by R. J. Walsh, President.

Witness: John A. Bennewitz. (Seal.) Attest: C. B. Matthai, Secretary, ITL.

Interstate Transit Lines, Inc., by R. J. Walsh, President.

Witness: John A. Bennewitz. (Seal.) Attest: C. B. Matthai, Secretary, ITLI.

Approved as to form: John A. Bennewitz, General Attorney.

Before United States Board of Tax Appeals [Title omitted]

Answer of Commissioner of Internal Revenue—Filed April 16, 1940

Comes now the Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and in answer to the petition filed in the above-entitled proceeding, admits and denies as follows:

- I. Admits that the petitioner herein was in 1936, and still is, a corporation of the State of Nebraska, with its [fol. 15] executive office at 2116 Leavenworth Street, Omaha, Nebraska. Denies the remaining allegations contained in paragraph I of the petition.
- II. Admits the allegations contained in paragraph II of the petition.
- III. Admits that the additional tax proposed by the deficiency letter for the calendar year 1936 is \$4,461.53. Denies the remaining allegation contained in paragraph III of the petition.
- IV. A and B. Denies that the Commissioner erred as alleged in subparagraphs A and B of paragraph IV of the petition.
- V. 1. Admits the allegations contained in subparagraph 1 of paragraph V of the petition.
- 2. Denies the matter contained in subparagraph 2 of paragraph V of the petition, except it is admitted that petitioner during the year 1936 was engaged in the operation of motor buses for the transportation of passengers between Chicago, Illinois, and Los Angeles, California.
- 3 to 6, inclusive. Denies the matter contained in subparagraphs 3 to 6, inclusive, of paragraph V of the petition.
- 7. Admits the allegations contained in subparagraph 7 of paragraph V of the petition.
- 8 to 13, inclusive. Denies the matter contained in subparagraphs 8 to 13, inclusive, of paragraph V of the peti-

Denies generally and specifically each and every allegation contained in the petition not hereinbefore specifically admitted, qualified or denied.

Wherefore, it is prayed that the Board redetermine the correct amount of deficiency involved in this proceeding to be equal to the amount determined by the Commissioner, [fol. 16] namely, \$4,461.53 in income tax for the year 1936, and that the petitioner's appeal be denied.

J. P. Wenchel, Chief Counsel Bureau of Internal Revenue.

Of Counsel: R. P. Hertzog, Division Counsel; Gene R. Reardon, Special Attorney, Appeals Division.

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 101692

United States Board of Tax Appeals, Interstate Transit Lines, Petitioner,

V.

COMMISSIONER OF INTERNAL REVENUE, Respondent

FINDINGS OF FACT AND OPINION OF UNITED STATES BOARD OF TAX APPEALS—July 9, 1941

Petitioner, a bus transportation company, has not established its right here to deduct as its ordinary and necessary business expense the operating deficit of its subsidiary, to the payment of which petitioner was committed by contract with the subsidiary.

Henry W. Clark, Esq., and Joseph F. Mann, Esq., for the petitioner.

Henry C. Clark, Esq., for the respondent.

Respondent determined a deficiency in income taxes of \$4,416.53 against the petitioner for the calendar year 1936. The only issue submitted is whether the petitioner is entitled to a deduction of \$28,100.66 as an ordinary and necessary expense of carrying on its business for that year.

FINDINGS OF FACT

The petitioner is a corporation created by the State of Nebraska, with its executive offices located at Omaha, Nebraska, where it filed its income tax return for the calendar year 1936. Since 1929 the petitioner has operated interstate bus transportation lines between Chicago, Illifol. 17] nois, and Los Angeles, California; and between Kansas City, Missouri, and Cheyenne, Wyoming, for the transportation of passengers, mail, and express. In addition to this interstate business, petitioner had acquired the right to handle intrastate business in the states along its routes, in the States of Iowa, Nebraska, Kansas, Colorado, Wyoming, Utah, and Nevada.

Petitioner could not then acquire the right to do intrastate business in California because the Public Utilities Act

-

of California required the certificate of the Railroad Commission for conducting a common carrier business on the public highways, and that commission, based on its interpretation of that act, refused to grant certificates for intra-

state operations to foreign corporations.

Petitioner, for the purpose of augmenting its income from carrying California intrastate traffic, which could be done without substantial increase in its facilities or expenses, and because of its inability to thus function, in 1930 organized a subsidiary corporation, under the laws of California, under the name of Union Pacific Stages of California, hereinafter called "Stages", which company, by 1932, had secured certificates authorizing it to conduct the desired intrastate operations. Petitioner furnished all its capital and received all its capital stock. On February 7 and 8, 1932, respectively, petitioner and Stages executed two contracts. The first of these, hereinafter called the "Absorption Agreement", recited that Stages was a wholly owned subsidiary of the petitioner, that it was maintained as an operating subsidiary of the petitioner and its operations conducted solely for the benefit of that company, and that, in order that the petitioner might obtain the greatest benefit from the operations of Stages, it was necessary that Stages operate on such routes and schedules as would most benefit petitioner. It provided that Stages would operate busses on such routes and schedules as directed by petitioner, in consideration for which petitioner agreed to assume and reimburse Stages for any operating deficits incurred by that company, and that Stages agreed to pay over to petitioner any operating profit resulting from its operations at the end of each calendar year. The second contract, hereinafter called the "Operating Contract", provided that Stages, in addition to its intrastate business in California, should conduct all of the interstate operations theretofore performed by petitioner in California. [fol. 18] agreement provided that when the busses crossed the Nevada state line, they should pass into the custody and possession of the respective companies there operating. was further provided that as the respective companies took over the custody and possession of the busses, a payment to the owners of 5 cents per mile run by each bus should be made and the "lessee" would be responsible to the "lessor" for the busses of the "lessor" in the "lessee's" custody and possession. In operating under this agreement there was

no change in the conduct of the business except that intra-California passenger and other transportation was available on the busses thus operating. No additional expense was incurred except the cost of petitioner keeping the separate accounts for Stages. At the outset, Stages acquired a local franchise from the Pickwick-Greyhound lines, together with two busses.

The stock of Stages was all owned by petitioner, and these companies had the same directors and officers. The above contracts were executed by the same persons as officers of the respective companies. Stages had its own accounting records, employees, busses, directors, and corporate minute book. Its accounting records were kept at the offices of petitioner by the officers and employees of petitioner, who kept petitioner's records.

Stages had no bank account. Petitioner collected all the revenues of Stages and paid all of the bills, pay roll and

otherwise, of Stages.

All revenues from operations of both companies were collected by petitioner and all expenses of both companies were paid by the petitioner. Monthly, petitioner apportioned on the books of the respective companies the revenues of the respective companies on the basis of passenger and traffic miles, compared to the aggregate of the same. Likewise, the expenses were apportioned except those, such as taxes, which were charged to the company liable therefor. The entry of those items was made in an open account of petitioner with Stages. A corresponding open account with petitioner was kept on the books of Stages. These accounts were designated cash accounts.

On the books of each company there was kept another open account with the other company which was used exclusively as a "clearing account" for the entry at the end of each year showing the absorption by the petitioner of the profit or deficit of the operation of Stages for the year. [fol. 19] For the calendar year 1936, involved here, Stages incurred an operating deficit of \$28,100.66, as shown by its books. As of December 31, 1936, that amount was charged to petitioner in the "clearing account" of Stages with petitioner, and, as of the same day, that amount was credited to Stages in the "clearing account" of petitioner with Stages.

As of December 31, 1936, before the foregoing entries were made, Stages on all open accounts was indebted to peti-

tioner in a net amount of about \$34,000, so that the foregoing entry reflecting the so-called "absorption" of the alleged deficit of \$28,100.66 of Stages for that year merely reduced the net indebtedness of Stages to petitioner, otherwise existing, by the amount of that alleged deficit, and left Stages indebted to petitioner in an amount exceeding \$5,000.

For the years 1932 and 1933, during which returns of affiliated companies were permitted, such returns were filed for

petitioner and Stages.

Several years after 1936, because of an amendment to the California Public Utility law or a modification of the Railroad Commission of California's interpretation of it, removing the inability of petitioner to obtain authority to conduct intrastate business in California, Stages was dissolved and liquidated and its assets, leases, and franchise transferred to petitioner, with the approval of that commission.

The accounts of both petitioner and Stages have at all times been kept on an accrual basis.

OPINION

Leech: The petitioner seeks to deduct \$28,100.66, the amount of the operating deficit of Stages for the year 1936, as shown on the respective books of petitioner and that company, as an ordinary and necessary expense in carrying on its business during that year. Sec. 23 (a), Revenue Acts of 1934 and 1936.

Respondent, by his contested determination, denies not only the right of the petitioner to deduct the item as an ordinary and necessary business expense, but apparently says also that the mechanics used do not constitute an accrual in fact of these items, since no cash settlement of the accounts between petitioner and Stages was made [fol. 20] until the dissolution of the latter in a year subsequent to 1936. We decide the issue on the first ground and pass the second.

Deductions are permissible, of course, only by legislative grace and, to avail itself of their benefit, the taxpayer must conform squarely with the legislation authorizing them. New Colonial Ice Co. v. Helvering, 292 U. S. 435. It is not necessary that either respondent or we characterize this accrual from an accounting standpoint. Connally

Realty Co., 31 B. T. A. 349; affd., 81 Fed (2d) 221; Baltimore & Ohio Railroad Co., 29 B. T. A. 368. Thus, to succeed here, petitioner has the burden of establishing that the contraverted accrual was an ordinary and necessary

expense of its business.

Stages was a separate, juristic taxable entity. Higgins v. Smith, 308 U. S. 473; Burnet v. Commonwealth Improvement Co., 287 U.S. 415. Its business was that of furnishing intrastate transportation within California. That was not and could not have been the business of petitioner, which, so far as California was concerned, was restricted to interstate business. The bus business of Stages, limited as it was to the State of California, did not become that of petitioner by virtue of petitioner's sole ownership of the stock of Stages. All Russian Textile Syndicate, Inc. v. Commissioner, 62 Fed. (2d) 614; certiorari denied, 289 U. S. 752; Alexander M. Bing, 30 B. T. A. 429; Mary E. Cappon, 28 B. T. A. 357. Stages was not organized, its stock was not acquired, and the contested accrual thereunder was not made by petitioner to increase the profits of the business of petitioner. Those facts were deliberately brought about by petitioner to augment its income by increasing the income of Stages, its wholly owned subsidiary, from the intra-California business of the latter company in which petitioner could not engage. The accrual in controversy thus may well have been in the nature of a capital expenditure and not an expense at all. Cf. Welch v. Helvering, 290 U. S. 111.

Moreover, whether any or all of the operating deficit of Stages for the taxable year was attributable to the intra-California business of that company is not disclosed. Whether that business was necessary to profitable operation of petitioner's interstate business in California does not even appear. In fact the opposite conclusion is at least inferable. Profit to its subsidiary in the Colifornia intrastate business was the motive which moved petitioner. [fol. 21] The contested accrual was made pursuant to the contract of February 7, 1932. All the capital stock of Stages, one party to that contract, was owned by petitioner at the time of the acquisition of that contract and throughout the life of the former company. Stages was therefore always entirely under the control of petitioner. Assuming therefore that the item in question was an expense of petitioner's business, on this record, including the absence

of evidence as to the ordinary and necessary expense of furnishing interstate transportation to and from within California, we do not think the petitioner has sustained its burden of establishing that any part of the operating deficit of Stages for the taxable year was an ordinary and necessary expense of the petitioner in the operation of its interstate business. Main Central Transportation Co., 42 B. T. A. 350. Cf. Welch v. Helvering, supra.

Respondent is sustained.

Decision will be entered for the respondent. (Seal of U. S. Board of Tax Appeals.)

BEFORE UNITED STATES BOARD OF TAX APPEALS

UNITED STATES BOARD OF TAX APPEALS WASHINGTON INTER-STATE TRANSIT LINES, Petitioner,

V.

COMMISSIONER OF INTERNAL REVENUE, Respondent

ORDER OF REDETERMINATION, JULY 9, 1941

Decision

Pursuant to the determination of the Board, as set forth in its Findings of Fact and Opinion, promulgated July 9, 1941, it is

Ordered and Decided: That there is a deficiency in income

tax of \$4,461.53 for the calendar year 1936.

Enter:

Entered July 9, 1941.

J. Russell Leech, Member.

(Seal of U. S. Board of Tax Appeals.)

[fol. 22] Before United States Board of Tax Appeals

Motion for Reconsideration, and Denial Thereof—Filed August 7, 1941. Denied September 3, 1941

Now Comes, Interstate Transit Lines, petitioner in the above entitled proceeding, and petitions for a reconsideration of the Findings of Fact made, and of the conclusion

reached in the Opinion, in the report herein, promulgated

on July 9, 1941.

The sole issue involved in this review proceeding before the Board is respondent's disallowance of the deduction, as an ordinary and necessary expense of the business of petitioner, of the 1936 deficit of its wholly-owned subsidiary, the Union Pacific Stages of California, hereinafter called "Stages". The proposed affirmance of respondent's disallowance of the deduction rests upon the conclusion that petitioner did not sustain its burden of establishing that any part of the operating deficit of Stages was an ordinary and necessary expense of petitioner in the operation of its interstate business.

The Findings of Fact

We address this motion first to the Findings of Fact made

in the report.

A very careful record was made in behalf of petition, addressed, of course, to establishing the ultimate fact as to which a failure of proof has been found. Indeed, at the hearing we feared that the testimony offered concerned such minute details as to the conduct of the business and affairs of petitioner and the Stages, that it might seem tiresome

to the presiding Member.

The facts proposed in petitioner's first brief were carefully formulated and sustained in every respect by the record. While the facts so proposed in behalf of petitioner have in general been found in the report, the findings of fact as made omit all or part, or modify the statement of, the facts proposed in six paragraphs of petitioner's first brief. We feel that, although some of the omissions and modifications appear small, in the aggregate the facts found by the Board fall sufficiently short of the facts proposed in behalf of petitioner to justify this motion for reconsideration of the findings of fact.

[fol. 23] We submit that every proposed finding of fact omitted from, or materially modified in statement by the Board's findings, has weight, in greater or less degree, as bearing on the result reached in the Board's opinion. We urge that none of the requests which are hereinafter made be rejected because of a thought that it is immaterial or unimportant. The court must get its factual basis and background solely from the facts as they may be finally

found, for the court did not have the benefit of hearing the testimony.

First request:

The first eight lines and two words of the ninth line of page 2 of the report are an extraordinary and wholly unnecessary condensation. They dispose in two sentences of six subjects: (1) The fact of the organization of a California subsidiary, (2) for the purpose of augmenting petitioner's income, (3) with no substantial increase in expenses, and (4) because of petitioner's own inability to do California local business, (5) the securing of Commission certificates for local business by the California subsidiary, and (6) the furnishing of the capital and issuing of the capital stock of the California Subsidiary.

We feel that this extreme condensation unduly prejudices petitioner in that it greatly dilutes and subordinates the record made as to the reason for organizing the Stages. Paragraph 4 of petitioner's proposed facts was a statement in the language of witness Haugh (Tr., p. 31) of the sole reason for creating the California company. His statement is strong and emphatic. Petitioner should not lose the benefit of the exact language of his testimony on this point.

Again, the phrase in the second and third lines of page 2 of the findings as to no "substantial increase" in petitioner's facilities or expenses might be interpreted as conflicting with or qualifying the finding, in lines 8th and 9th from the end of page 2, that there was no additional expense except some bookkeeping cost. The latter location, following as it does the facts about the "Operating Contract", is the more appropriate. We prefer the finding of no expense, above mentioned.

So, we request that there be substituted for the first two sentences of the findings on page 2, being the first eight [fol. 24] lines and two words on the ninth line, the following:

Petitioner, being unable itself to secure a certificate for handling local traffic in California, caused to be organized in 1930 a subsidiary corporation under the laws of California under the name of Union Pacific Stages of California, hereinafter called "Stages". (Tr., pp. 18-19.) There was one reason and one reason only for creating a California

subsidiary, and that was to enable the parent company through the agency of the California company, to secure a certificate of public convenience and necessity from the California commission to handle intrastate passengers within the State of California and thereby augment its gross revenue and its net income. (Tr., pp. 30-31.) Petitioner furnished all the capital for and received and owned all the capital stock of Stages. (Tr., pp. 61 and 95.) At the outset Stages acquired by purchase a local franchise from the Pickwick-Greyhound Line, with the approval of the State commission, together with two buses, and by additional applications secured Commission certificates by 1932, which together constituted local franchises from the Nevada-California state line to San Bernardino, California. (Tr., pp. 5, 18, 19.)

The above text corresponds with petitioner's proposed facts, paragraphs 3 and 4, and the last sentence of paragraph 9.

Second request:

The findings in respect of the provisions of the "Operating Contract" beginning about the middle of page 2 follow in general paragraph 6 of the proposed facts in petitioner's first brief, but with some change of language. However, there has been omitted the provision as to drivers. We request that this provision be restored as being an important feature of the actual operations. The sentence as to the change in the custody and possession of the buses at the state line is awkward, and we suggest a restatement simply as an improvement of the language. The bus rental provision is unimportant and can be shortened.

So, we suggest the following as a revision of the text of the two sentences beginning in the 19th line from the end [fol. 25] of page 2 and ending in the 12th line from the end

of that page.

The agreement provided that the buses operated by either company to the California-Nevada state line, upon crossing that line, should pass into the custody and possession of the other company; that the buses should be subject to a rental payment to the owning company; that the drivers of the buses should be the employes solely of and their wages paid by the company having the custody and possession of the buses; and other provisions were made as to the apportion-

ment of expense of maintaining and operating the buses and insurance, and as to taxes. (Exhibit C to petition.)

Third request:

We ask, for the sake of accuracy in the narrative, that there be inserted in the 12th line from the end of page 2 of its report, as an additional sentence following the period, the following:

The two agreements aforesaid, described as the Absorption Agreement and the Operating Contract, at all times governed the accounting of both companies and were strictly observed.

This finding was requested in paragraph 11 of petitioner's proposed facts and is supported by the testimony at page 61 of the Transcript.

Fourth request:

There is a faulty expression in the 10th line from the end of page 2 of the report, in the exception to the finding that in operating under the operating agreement there was no change in the conduct of the business. The exception reads: "except that intra-California passenger and other transportation was available on the busses thus operating." This is an inexact statement.

We request that there be substituted for the text just quoted the following:

except that California passengers for travel between local points were available to the through buses. The buses theretofore operated by petitioner continued to be operated to and from Los Angeles, with the same drivers and on the [fol. 26] same schedules as theretofore. There was no break in the operation of the buses or change of passengers at the California-Nevada state line.

The first sentence of the above suggested substitute merely corrects the text of the finding. The second and third sentences accord with paragraph 8 of the petitioner's statement of proposed facts and are supported by the testimony (Tr. pp. 23-24 and 28). Their addition is of some importance in giving an understanding of the way in which the operations of the two companies were conducted.

Fifth request:

We request that there also be added to the findings, following the amended and additional text above stated under our fourth request, the following:

The advantage of obtaining the California local business through Stages was that petitioner had been operating its interstate buses to and from Los Angeles, California, and there were vacant seats in all the buses on the California part of the route, so that, by having the intrastate franchise, it was possible to obtain local passengers to occupy such vacant seats.

This proposed additional text was not specifically requested as a finding in petitioner's first brief. It is proved by the testimony (Tr., pp. 24 and 15), and we think its addition will further clarify the operating situation. We hope this text may be added.

Sixth request:

We suggest that the sentence in the 7th to 9th lines from the end of page 2, reading: "At the outset, Stages acquired a local franchise from the Pickwick-Greyhound lines, together with two busses." be struck out. The information is covered in substance by the finding now in lines 6 to 8 of page 2, and will be covered in detail if petitioner's "First request", for the revision of the first few lines of page 2, is granted.

[fol. 27] Seventh request:

We again propose the finding, stated in paragraph 10 of the proposed facts in petitioner's first brief, and accordingly request that the following be found:

It was assumed prior to the formation of Stages that there was available local business between points in California along the route of petitioner's interstate buses to the amount of \$10,000, and while separate account of the revenue from local business has not been kept, the officers of petitioner believe that such revenue exceeded that amount annually and did so in 1936 (pp. 23-24).

The best place for the insertion of the above text is at the end of the text requested as an additional finding in our foregoing "Fifth request".

This requested addition, we admit, is not important, but it seems no more than fair to give the Court some information as to the probable amount of the California local business.

Eighth request:

The sentence in the 4th and 5th lines from the end of page 2 is a partial duplication. It reads: "The stock of Stages was all owned by petitioner, and these companies had the same directors and officers." It has already been found in the 8th and 9th lines of page 2 that petitioner acquired all the capital stock of Stages. We request, therefore, that this duplication be eliminated and the sentence confined to the identity of directors and officers as between the two companies.

Ninth request:

The last complete sentence on page 2 reads: had its own accounting records, employees, busses, directors and corporate minute book." This finding is literally supported by testimony found in the transcript at pages 33 and 55. The affirmative answers, which could not have been intended literally in the light of other testimony, were brought out by a series of questions apparently more or less rhetorical and designed to show merely that Stages was a separate corporate entity — "a separate, juristic taxable entity", as it is characterized in the opinion. There is no [fol. 28] dispute about this on the part of petitioner. But the quoted sentence seems objectionable in its implication of an entirely separate and independent organization and staff. Of course, any such implication as to accounting records is qualified by the following sentence which shows that the accounting records of Stages were made at the offices of petitioner by the same people who made petitioner's records. As to buses, it appears in a previous finding that Stages acquired two buses. As to directors, the second preceding sentence finds that petitioner and Stages had directors and officers in common. As to employees, a finding which we have requested concerning the bus drivers will show that they also were common employees. Nevertheless this sentence seems somewhat objectionable and we request that there be substituted for it the following:

Nevertheless Stages was a separate corporate entity for income tax and other purposes and it was always recognized as such by petitioner.

Tenth request:

The report in the 4th paragraph of page 3 contains the finding: "For the calendar year 1936, involved here, Stages incurred an operating deficit of \$28,100.66, as shown by its books." Then follows a finding as to the charging and crediting of this deficit in the intercompany clearing accounts. We request that at the end of this paragraph there be added the following:

The deficit would have been greater without the local business in California (transcript, page 71).

This additional text was not requested in petitioner's first brief, but we think it is desirable that the finding as to the 1936 deficit have this small clarification.

The Opinion

We address this motion, in the second place, to the opinion of the Board in the report promulgated on July 9, 1941. We do so very briefly, because we advanced in petitioner's first brief, on pages 9 to 11, and 14 and 15, the facts of record and the considerations which we thought supported the allowance of the Stages' deficit as an ordinary and necessary expense of petitioner's business. The Board [fol. 29] Member who presided at the hearing concludes that our proof was inadequate, and the argument in our first brief was evidently not convincing to the contrary. There is probably no justification for our asking a reconsideration of the final conclusion in the Opinion. so only because it seems that there must be a misunderstanding either on our part or on the part of the Board Member as to some of the testimony, and indeed, as to one of the findings made.

It is stated in the opinion, on page 5, as follows:

"Moreover, whether any or all of the operating deficit of Stages for the taxable year was attributable to the intra-California business of that company is not disclosed."

It is this statement in the opinion to which we have referred in suggesting that there is some misunderstanding involved in the opinion. It has been found as a fact that "No additional expense was incurred except the cost of petitioner keeping the separate accounts for Stages." We understand

the Court's finding as meaning that the conducting of local 'bus operations in California, that is, the transportation of passengers between California local points on buses which had been and were to continue to be operated in any event for interstate traffic, caused no increased expense. the fact, according to the undisputed testimony. That being so, it necessarily follows that no part of the deficit in question was attributable to the local business. An operating "deficit" is an excess of operating expenses over revenues. Since no expense was incurred in transporting the California local passengers, there could be no deficit from the local operations. It seems to us that the Board member must have some different understanding of the facts, including the meaning of his own finding as to the absence of any additional expense. But we submit that no other understanding of the testimony is justifiable.

Since none of the deficit in question resulted from a California local business, it necessarily is a deficit incurred in the California part of the interstate bus operations as allocated to Stages in the apportionment of interstate revenues and expenses. If Stages had not been organized, the same deficit (in fact, a somewhat larger one) would have [fol. 30] existed inevitably, although it would not have been an ascertained amount in the absence of an apportionment to California of the revenues and expenses of interstate operations.

Upon organizing Stages and making the Absorption Agreement and the Operating Contract between the two companies, the necessity of an apportionment to California of the interstate revenues and expenses became necessary for the first time. The only effect in such apportionment of the revenues from California local passengers was that such revenues increased the profit or decreased the deficit otherwise shown as the apportionment to California of the interstate revenues and expenses.

We concede fully to Stages the status of a separate, juristic taxable entity. We may concede also recognition of separate business operations by petitioner and Stages to the utmost extent justified from the most legalistic standpoint. Nevertheless, the Absorption Agreement and the Operating Contract cannot be ignored; they must be accorded at least the same effect that would be given them if they were contracted between corporations wholly unrelated

by stock ownership, or, directors and officers, and such concession ignores the recital in the Absorption Agreement (page 15 of Petition) that the operations are "conducted solely for the benefit of" petitioner. The purpose of these agreements was to provide Stages with the use of buses on which local passengers could be transported, and at the same time continue petitioner in the enjoyment of any profit which it had theretofore realized from its interstate operations into Southern California, but subject to the continuance of its liability for the expenses of such operation.

The contractual relations created between the parties did not give rise to any new liability or expense; they were intended merely to leave the net result of the operations into Southern California with petitioner, just as they had been before, except for the slight improvement in the result due to additional revenue from California local passengers. The intended result was accomplished from the accounting standpoint. We believe that there is no reason why the result may not be given its appropriate effect under the tax law.

[fol. 31] Wherefore, it is prayed that the foregoing requests for changes in the findings of fact made in a report of the Board promulgated July 9, 1941 be granted, and that the opinion in said report be reconsidered, and its ultimate conclusion withdrawn.

Henry W. Clark, Joseph F. Mann, Darwin P. Kingsley, Jr., 120 Broadway, New York, N.Y.; Harry J. Gerrity, Hill Building, Washington, D. C., Counsel for Petitioner.

Dated: New York, N. Y., August 6, 1941.

Denied September 3, 1941,

J. Russell Leech, Member, U. S. Board of Tax Appeals.

BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

Petition for Review-Filed November 26, 1941

Interstate Transit Lines, Petitioner, is aggrieved by a decision of the United States Board of Tax Appeals rendered on the 9th day of July 1941, in the case of Interstate

Transit Lines, Petitioner, vs. Commissioner of Internal Revenue, No. 101692, and the denial by the United States Board of Tax Appeals on the 3d day of September 1941 of motion of the Petitioner for a reconsideration thereof, determining that there is a deficiency of Petitioner's federal income tax for the year 1936 in the amount of \$4,461.53, [fol. 32] and respectfully submits its petition for a review thereof by the Circuit Court of Appeals for the 8th Circuit.

I

Venue

The Petitioner's income tax return for the year 1936 was filed in the office of the United States Collector of Internal Revenue for the District of Nebraska, located in the 8th Judicial Circuit.

II

Nature of the Controversy

The controversy involves the determination of the Petitioner's federal income tax for the calendar year 1936. The sole issue involved in this appeal is that designated A in its petition to the Board and entitled "Union Pacific Stages of California—Operating Loss." Petitioner claims the right to deduct as an ordinary and necessary expense incurred in its business, the sum of \$28,100.66, which represents the deficit incurred by Petitioner's wholly owned and completely dominated subsidiary, Union Pacific Stages of California (herein referred to as "Stages"), which deficit was absorbed by Petitioner and the amount thereof paid to said subsidiary under an agreement dated February 7, 1932, between Petitioner and its said wholly dominated and controlled subsidiary.

Assignment of Errors

The Board of Tax Appeals erred in its decision in the following respects:

In refusing to allow Petitioner in computing its 1936 net income to deduct as an ordinary and necessary expense incurred in its business, an item of \$28,100.66, which represents the deficit of Petitioner's wholly owned and completely dominated subsidiary, Union Pacific Stages of California,

which sum was absorbed and paid by Petitioner to said subsidiary pursuant to an agreement dated February 7, 1932 between Petitioner and its said wholly owned and completely dominated subsidiary, and more particularly the [fol. 33] following rulings as the basis of such refusal:

- (a) In heiding that the contested accrual of \$28,100.66 "may well have been in the nature of a capital expenditure and not an expense at all."
- (b) In holding that "whether or not any or all of the operating deficit of Stages for the taxable year was attributable to the intra-California business of that Company is not disclosed."
- (c) In failing to hold that intra-California business reduced the deficit which Stages would have suffered in the through business taken over from petitioner.
- (d) In holding that "whether the intra-California business was necessary to profitable operation of petitioner's interstate business in California does not even appear."
- (e) In holding that the conclusion is at least inferable that the intra-California business of Stages was not necessary to the profitable operation of petitioner's interstate business in California.
- (f) In holding that profit to its subsidiary in the California intra-state business was the motive which moved petitioner.
- (g) In failing to hold that increased profit in the entire operation of the bus business as a whole by petitioner and its subsidiaries was the motive which moved petitioner to turn over the California through business to Stages which, as a California corporation, secured a license to do an additional California intra-state business.
- (h) In failing to hold that in the conduct of interstate and intrastate business within the borders of California, Stages was a mere agent or instrumentality of the petitioner.
- (i) In holding that petitioner did not sustain its burden of establishing that any part of the operating deficit of Stages for the taxable year was an ordinary and necessary expense of the petitioner in the operation of its interstate business.

- [fol. 34] (j) In failing to hold that petitioner was obligated, under the contract of February 7, 1932, to reimburse Stages for any deficits incurred in its operation.
- (k) In failing to hold that such reimbursement by petitioner to Stages was an ordinary and necessary expense of petitioner's business.
- (1) In failing to make the several findings of fact requested by the petitioner, and each of them, as set out in the motion for reconsideration.

Dated: November 25, 1941.

Henry W. Clark, Attorney for Interstate Transit Lines.

Nelson Trottman, Of Counsel.

Duly sworn to by Leo J. Tracy. Jurat omitted in printing.

[fol. 35] Before United States Board of Tax Appeals [Title omitted]

STATEMENT OF EVIDENCE

The following is a statement of evidence submitted to the Board of Tax Appeals in the above entitled case so far as is necessary to the assignment of errors heretofore filed, reduced to narrative form:

This proceeding came on for hearing before Honorable J. Russell Leech, a member of the United States Board of Tax Appeals, on the 21st day of January, 1941, at 201 Varick Street, New York, N. Y. Henry W. Clark, Esq. and Joseph F. Mann, Esq., appeared for the taxpayer, and Henry C. Clark, Esq., appeared for the Commissioner. After statements of the case for both the taxpayer and the Commissioner were heard, the following testimony was introduced with respect to the issues on appeal:

JESSE L. HAUGH called as a witness on behalf of the Petitioner, being first duly sworn, testified as follows:

Direct Examination.

Note: For convenience the Petitioner is referred to as the Nebraska company and the Union Pacific Stages of California is referred to as the California company. My name is Jesse L. Haugh and my residence is Omaha, Nebraska. I am a Director and Vice-President of Interstate Transit Lines, the petitioner. I have been a Director of that company since July 1, 1929, and Vice-President since 1935. The Nebraska company since my acquaintance with it in 1929 has conducted the business of transporting passengers, mail and express over a route from Chicago to Los Angeles and from Kansas City through Denver to Cheyenne, connecting with the first named through route, by motor bus on the public highway. It has not engaged at any time in any other business.

Beginning with my directorship in 1929 I have really been the Managing Director of the Company and have had a [fol. 36] substantial part in the development of the policies

and in the organization and in the management.

Mr. R. J. Walsh has been President during the entire period. His attention to the business has been confined largely to operations of the company. It is the other matters that have been in my special charge, although I have been acquainted with the operations, too.

The through routes of the operation that I referred to, from Chicago to Los Angeles and from Kansas City through Denver to Cheyenne, were first established for interstate

business.

Thereafter the Company applied to each of the state commissions for certificates to handle intrastate passengers, mail and express, that is, to handle passengers between the cities in the same state. It did that in the states of Iowa, Nebraska, Kansas, Colorado, Wyoming, Utah and Nevada. It has not at any time done any local business, that is, intrastate bus operation in California. braska company never obtained a certificate from the California Commission authorizing it to do any intrastate business in California because it was the policy and the practice of the State Railroad Commission of California to grant certificates for intrastate operations to local companies only, that is, to companies incorporated in the State of California and it would have been futile under the practice of the Commission for the Nebraska company to have applied for a certificate. It was a matter of policy adopted by the Commission and it was the manner in which the Commission construed the California law, that it could not grant such a certificate. That policy was well known to representatives of the Nebraska company.

It was considered in 1929 and in the immediately following years that there was a desirable amount of intrastate passenger bus traffic available in California. Our review of that indicated that there was a substantial amount of revenue that could be added to the interstate schedules. To obtain that local business the first step was to organize a company with an incorporation in the State of California because that was the only way by which the Commission would grant the right. That company was organized and named the Union Pacific Stages of California. That California subsidiary succeeded in obtaining local franchises. [fol. 37] It secured local franchises extending from the Nevada-California state line westward to San Bernardino. The first was secured through a transfer of a certificate that was bought from the Pickwick Greyhound Lines in The transfer from the Pickwick G. evhound Lines required and received the approval of the California Commission. Although the California subsidiary was organized in 1930, it was not in a position until some time in 1932 to operate. That was because the State Commission did not grant more than one franchise over a given route so that it was necessary first to secure a franchise that might be transferred to the new company.

I am familiar with the original agreements of February 7, 1932, and February 8, 1932, copies of which are printed with the petition and designated Exhibits B and C. I have personally compared those particular exhibits with the original agreements. The printed exhibits are exact copies of the original agreements. The original agreements, of which those are copies, were made between the Nebraska company and the California company at or about the dates

I have indicated.

Counsel for Petitioner: I offer in evidence Exhibit B at-

tached to the petition.

Counsel for Respondent: The Respondent interposes an objection to the receipt in evidence of Exhibit B upon the following grounds: It is not competent for parties to any agreement to undertake thereby to determine in any manner how it will affect the computation of Federal income or profits taxes, the allocation of items of income or of deductions from income and the document offered can have no other purpose in this case.

The Member: That is the only basis of your objection?

Counsel for Respondent: Of course, I will also add the usual objections that it is irrelevant and immaterial to any of the issues here.

The Member: Objection overruled and exception to the Respondent.

Counsel for Petitioner: Now, I offer Exhibit C attached to the petition in evidence.

Counsel for Respondent: I have no objection to Exhibit C.

The Member: Received. Let the record show that those exhibits are received here as Petitioner's Exhibits 1 and 2.

[fol. 38] (Exhibits B and C received and marked Petitioner's Exhibits 1 and 2 respectively of this date,) in evidence.)

I have with me the originals of those two agreements. I examined them yesterday. I am familiar with the signatures of the officers who executed them. They were there and I saw their particular signatures.

After the making of these agreements, the California end of the bus business of the Nebraska company was continued

pursuant to Exhibit C, the operating agreement.

Under the operating agreement which is Exhibit C, Exhibit 2 as admitted in evidence, the interstate business between those lines was treated as conducted by the California company rather than by the Nebraska company, although the Nebraska company had, prior to the making of the agreement, operated through to Los Angeles. Insofar as passengers were obtained between the points of origin and destination in California, that local business was treated as handled entirely by the California company.

We estimated at the time that there would be about \$10,000 added to the revenue by reason of intrastate business. Although we have never kept the accounts separate as to the revenue from the intrastate business and interstate business, it probably exceeds that amount, and did in

1936.

The advantage from the standpoint of the Nebraska company in obtaining that California local business through a California subsidiary was that: The Nebraska company had been operating the interstate buses to California and there were vacant seats in all the buses, so that it was possible by having the intrastate franchise and by handling local passengers to obtain additional passengers without additional

expenses, the gross revenue being carried frequently to net income. The local business was handled on the same buses that had been operated previously by the Nebraska company. The same buses, same schedules, no additional schedules added nor any additional buses, nor any additional agents or stations established. There were no physical changes whatsoever in operation created by the formation of the California subsidiary.

There were changes in bookkeeping only, setting up the separate accounts for this new company. No additional expense was created by the California local business, unless [fol. 39] it would be a slight additional expense in account-

ing, opening a new set of books.

The bus terminal in Los Angeles was first secured by the Nebraska company. Then, after the California company was formed, it was transferred to the California company and in 1936 stood in the name of the California company. It was a leased terminal.

The depots in California were generally operated by the bus line on a basis whereby they were to pay a commission to the owner of the place, the drugstore or restaurant, hotel, filling station, and that commission would cover the use of the premises. The labor of selling the tickets and those agency agreements were on behalf of the California company in the State of California after the California company was formed.

There was a garage lease at Los Angeles which was first taken in the name of the Nebraska company and then when the California company was formed that was transferred

to the California company.

Referring to the so-called depot arrangements, that is, stopping places where passengers can buy tickets, there were no more of those after the addition of the local service than before. Those agencies were opened by the Nebraska company for the interstate business; for instance, a sale of a ticket from Victorville, California, to Salt Lake City. Utah, or from Victorville to Las Vegas, Nevada, or some place out of the state. The same agencies that sold interstate became the agencies for intrastate tickets.

After the execution of the contract, which is Exhibit C to the petition, the California company purchased two buses as its proportion of the equipment. These were purchased from the Pickwick Greyhound Lines when the franchise and the equipment was bought from them in 1932, at the beginning of the California company's operation. Then those two buses operated in a pool with the parent company's buses. In after years through 1936 no additional buses, in addition to those first two, were acquired for or

allotted to the California company.

As to officers of the two companies: The Nebraska and California companies had five directors. They were exactly the same directors at all times. Each company had a President, a General Superintendent, Traffic Manager, Auditor, [fol. 40] Assistant Treasurer, Secretary, and those officers were concurrent, that is, the same men were occupied with the same positions on the California company that they had on the Nebraska company. The direct charge of operations—immediate charge, was vested in a Superintendent at Los Angeles who had jurisdiction over the territory in California and from the California line to Las Vegas, Nevada.

There was no actual break in the operation of buses or change of passengers from one bus at the California and Nevada state line after the California company assumed the operations in California. The buses operated through from Salt Lake City, Utah, about 800 miles west to Los Angeles and about 300 miles of that distance was in the State of California, and the balance in the State of Nevada and in the State of Utah. There was no difference at all in crossing the state line, that is, the same bus operated through from Salt Lake City to Los Angeles.

In the creation of the California subsidiary and the agreements made between it and the Nebraska company, there was no purpose to affect income taxes whatsoever.

I would like to add to that, with the approval of counsel, that we hesitated and did not want to form this California company. It became necessary in order to augment the income of the parent company to do it. After having formed it, we wanted to make it as simple as possible because in the matter of management we were not concerned as to what either company separately made, but what the parent company made through the second company.

To do that, it was necessary to consolidate all the expenses and revenue and frankly, I never paid any attention and neither did Mr. Walsh, the President, pay any attention, to the California company because those were absorbed by this agreement by the earnings of the parent company and it wasn't necessary to look upon this rather arbitrary divi-

sion of revenue and expenses.

There was one reason and one reason only for creating the California company, and that was that the parent company through the agency of the California company, might secure a certificate of public convenience and necessity from the California Commission to handle intrastate passengers within the State of California and thereby augment its gross revenue and its net income.

That was the sole purpose. When, afterwards, [fol. 41] the law was modified, I think in 1937, the California company was immediately dissolved. In other words, sometime after the year 1936, which is the tax year, we were able either by reason of a change in the law or by reason of a change in the views of the California Commission to dispense with the California company and we did do that. The California company was actually dissolved and all of its assets and leases and operations were transferred to the Nebraska company. With the approval of the Commission the franchises and operating rights were transferred to the Nebraska company and are now being operated by the Nebraska company.

The Member: That is to say, you are now doing an intra and interstate business in California by the taxpayer here.

The Witness: Yes, sir, that was made possible by a change in the law in 1937.

Cross-examination.

By Mr. Henry C. Clark (Counsel for Respondent):

Q. This contract, Exhibit B, and also the contract, Exhibit C, attached to the petition, which have been offered as Petitioner's Exhibits 1 and 2, are executed, by each of them, by the President of the respective companies who was the same individual and with the same name.

A. Yes, sir, the same name and the same man.

Q. Mr. Haugh, would you want to advise the California Railroad Commission that this California subsidiary while it was in operation was a mere dummy or subterfuge?

A. It was not a subterfuge, sir, and further than that, before the California company was organized, the California Railroad Commission was advised entirely about it and approved it.

Q. You had a separate corporation, of course?

A. Yes, sir.

Q. And that is what you told the California Railroad Commission you would do?

A. Yes, sir.

Q. And you had separate books?

A. Yes, sir.

Q. There is no doubt it was a separate institution?

A. It was a separate incorporation.

[fol. 42] Q. With its own accounting records?

A. Yes, sir.

Q. Its own employees?

A. That is correct, sir.

Q. And its own separate business?

A. That is correct.

Q. And continued in that condition for five years or more?

A. Yes, sir.

Q. And that was the situation in 1936?

A. That is correct.

Q. Do you have any connection with the Union Pacific Railroad Company?

A. Yes, sir, Vice-President.

Q. How long have you held that office?

A. Since 1929.

- Q. The California company insofar as any agreements of any form were required for carrying out the business in California entered into such agreements itself, did it not?
- A. That was necessary, that the Nebraska or parent company could, through a very necessary agency, augment its income.
- Q. But when the California company started in business, it really was in business?

A. Yes, sir.

Q. Doing business?

A. Yes, sir.

Q. Making agreements every day?

A. I wouldn't say that. Q. Well, selling tickets?

A. Yes, sir, selling tickets.

Q. There probably wasn't a moment of the day but when it had busses running on the road, is that right?

A. That is right.

Q. And it had its own Directors meetings?

A. Yes, sir.

Q. And its own separate corporate minute book!

A. Yes, sir.

[fol. 43] Q. And the Directors met for the California company from time to time?

A. That is correct.

Wade A. Hall called as a witness on behalf of the Petitioner, being first duly sworn, testified as follows:

Direct examination.

My residence and office is in Omaha, Nebraska. I am the auditor of the Nebraska company and have occupied that position since December 1, 1930. I am also the auditor of the California company, the Union Pacific Stages of California. I have had that position ever since the operation started. I think it was organized prior to De-The function of the auditor of these bus companies is to require accounting reports covering the operation of the company. To properly account for the revenue and expenses of the corporation. I am generally in charge of their accounting and am the head of the Accounting Department. The actual book entries are made by bookkeepers in my department, but I or some subordinate of mine directs what the entries shall be. The accounts of both companies have at all times been kept on the accrual basis. I have brought from Omaha the ledgers and journals of the two companies covering the period from 1928 to 1938, that is, the Nebraska company and the California company to 1938. The stock of the California company at all times since its organization—I do not mean registered ownership necessarily, but the actual ownership—has been owned by the Nebraska corporation.

I am familiar with the two agreements of February 7 and February 8, both in 1932, between the California and Nebraska companies, which have been introduced in evidence here. Those agreements have governed the accounting of the two corporations. In the accounting I have had done for the two corporations, the contracts have been strictly observed. The California company does not have a bank account. The Nebraska corporation has. The California company never has had any bank account. The method of handling the revenues and expenses of the California company never has had any bank account.

fornia company by the Nebraska company in its capacity of [fol. 44] its banker is as follows: In the first instance, the Nebraska corporation collects all the money and pays all the bills. The intrastate revenue is assigned to the California company. Transactions in which the California company had some interest are booked in open account with the California company. The California company has an open account on its books with the Nebraska company. The general officers of the Nebraska company are the general officers of the California company and receive salaries. There is an apportionment of their salaries made with the California company. In the case of employees of the Nebraska company below the classification of general officers, but referring to employees who participate to some extent in the conduct of the California business, they are carried on the Nebraska company payrolls. The Stages company has no payroll. Those employees are paid by Interstate Transit Lines payroll vouchers-its checks, because the California company has no bank account on which to draw pay checks. Their compensation as shown by the payroll is for their Interstate Transit Lines service, whether performed in California or in other states, without an attempt to segregate it on the payroll. And finally, as to those employees, they do not receive any separate pay check from their services in California.

At the beginning of its operation (California company) in 1932, the Nebraska corporation paid for the buses allocated to the California company originally and transferred them to the California company through open account. The arrangement was that the California company would take the two buses from the Pickwick Greyhound Lines. However, the Nebraska corporation paid for the buses and in doing so transferred the cost to the California corporation through open account. And on the California company's books, that cost was charged to a property investment account. Intrastate revenue that was local to the State of California was assigned direct to the California corporation, and to the California corporation is apportioned their share of interstate passenger revenue on the

Payroll was apportioned among the companies on the basis of the ratio of the revenue motor coach miles of the California company to the total revenue motor coach miles for the particular month involved. That apportionment

passenger mile basis.

was computed monthly. In the apportionment of revenue, [fol. 45] when the apportionment for the California company has been determined, entries are made on the Nebraska corporation's books turning the amount over through open account to the California corporation, and the California corporation sets the revenue up in its revenue accounts carried in open account on its books with the Nebraska corporation. And after the payroll apportionment has been made, the California company's share of the payroll for the month is charged in the open account on the Nebraska company's books. It is set up in the operating expenses of the California company. There is an apportionment made of fuel consumed on the mileage basis,-revenue motor coach basis. Cost of repairs is apportioned on the revenue motor coach miles as explained for the payroll. Miscellaneous expenses are accorded the same treatment. All revenues and expenses received and paid by the Nebraska company are booked first by it without any apportionment, just as if they were its own receipts and expenses, and then at the end of the month the apportionments which I have mentioned are made. The California company's apportioned share as computed is credited or charged in the open account. Then for the first time only is there any bookkeeping to be done for the Stages Company as to the apportioned revenue. There are some items, however, which are directly booked on the California company's books without apportionment. These are payments made by the Nebraska company for capital expenditures for the California corporation. They are handled in the open account of the California corporation, and likewise on the California corporation books the amounts are set up in investment account. Capital expenditures made for the California company would not get into its income accounts nor in its expense accounts. And taxes paid by the Nebraska corporation for the California corporation are charged through the open account to the California corporation, but not subject to any apportionment; also depreciation of the California buses. I have referred several times to the open account, which includes capital advances in which capital advances are entered. There is also a second open account on the books of each company that is used solely for the debiting or crediting of the profit or loss at the end of each year under the absorption agreement, which is Exhibit 1 in evidence. That profit or loss,

as the case may be, is determined solely from the income [fol. 46] account of the California company and expense accounts and tax accounts and depreciation accounts-operating revenue and expense statement, the difference between the two. The second open account does not in any way reflect any capital expenditures or capital transactions.

The method of accounting which I have described has been the same from the beginning of the California company's operations through 1936. It would be hard to determine whether the keeping of separate accounts for the California company has caused additional expense. There would be some because you have more entries to make and naturally there would be more cost. The account books cost something and it would take time to make the entries, and the ink costs something. It would be hard to say whether it meant an additional employee or additional bookkeeper or other employee because, as I mentioned, in making these entries and recording them,—the items in the accounts.—there are a certain portion of several clerks' time involved here. It would be hard to set it down. The work of my department has been increasing all the time so that a gradual increase in my force has been going on due to various causes, partly due to increase of general business and State requirements with respect to Court records and Interstate Commission reports. I have 67 employees in my department at the present time. That includes not only bookkeepers but stenographers, chief clerks, bureau heads and office boys.

Consolidated returns were filed for 1932 and 1933 by the California company and the Nebraska company. answer admits the allegation of paragraph 7 of the petition that the California company incurred a deficit of \$28,-100.66 in its operations during the year 1936. This deficit would have been greater without the local business in California. I believe 1936 was the first year we operated at a loss in California, the California corporation,-also 1932 and 1933. Profits were made in the remaining years. This is a photostatic copy of what we call the second,-what I called in my testimony a little while ago the second open account kept by the Nebraska company with the California company for the purpose of clearing the yearly profits and losses. It covers all the years of the California company's operations 1932 to 1938. That bears out my recollection

that there was a loss for 1932.



The Member: Is there an objection?

Counsel for Respondent: No, your Honor, but I wish Mr. Clark would show from what company's books this comes.

Counsel for Petitioner: My question was meant to include it as a page of the account from the Nebraska company's ledger showing its open account—second open clearing account with the California company.

The Witness: It is.

Counsel for Respondent: Very well.

Counsel for Petitioner: I offer it in evidence.

Counsel for Respondent: No objection.

The Member: Received.

(Account speet, received and marked Petitioner's Exhibit 3 in evidence.)

The loss for 1936 was handled on the accounted for on the California books through open account with the Nebraska corporation and likewise accounted for on the Nebraska corporation's books through open account. have before me the California company's books. Nebraska books we have a credit to the open account of Union Pacific Stages of California-net profit or deficit from operations. I will read into the record the entry for 1936 which appears in Exhibit 3. This is a photostatic copy of the account on the Nebraska corporation entitled Union Pacific Stages of California net profit or deficit from operation, and shows for the year 1936 an item credited for that account of \$28,100.66, as of December 31, 1936. That entry represents the loss in the California corporation for the year 1936. The entry was made on the books of the Nebraska company because that is the only means we have in our accounting system to clear the item. It was made on account of the Interstate Transit Lines company agreement of February 8, 1932, whereby it absorbed the deficits. This account is wholly confined to absorption of profits and losses by the parent company of the profits and losses of the California company. In the years in which the California company suffered losses the Nebraska company absorbed the California company's losses through this account, and in. the years in which the California company made profits the [fol. 48] Nebraska company absorbed those profits through this account, and this account represents no other transactions than those profits or losses. This account represents the accounting under the absorption contract. This photostat, taken from page 23 of the general ledger of the Union Pacific Stages of California, the California corporation, is an account on the books of the California corporation to which the losses or profits of that corporation is set up in open account with the Nebraska corporation.

Mr. Mann: I will offer that photostat in evidence from page 23 of the general ledger of the California company.

Counsel for Respondent: No objection.

The Member: It will be received.

(Account sheet received and marked Petitioner's Exhibit 4 in evidence.)

For 1936 the account shows a debit item of \$28,100.66. That item represents the loss for the year 1936 of the California corporation. That loss was so entered in this account because this is the account to which we go for the profits and losses of the California corporation as per the contracts and arrangements with the Nebraska corporation. Through this account the California company charged the Nebraska company with its losses and credited the Nebraska company with its profits, and that was done under the absorption agreement of February 8, 1932. There are no other entries in this account other than such charges and credits as I have just mentioned.

Cross-examination.

By Mr. Henry C. Clark (Counsel for Respondent):

Q. Mr. Hall, from what account did you take this item of \$28,100.66 that is entered on the accounts you have just been looking at?

A. From the income account.

Q. Is this what you referred to, I am not sure?

The Member: What has the witness in his hand?

The Witness: This is a ledger account of the Nebraska corporation entitled "ledger account—Interstate Lines, Inc.—open account".

By Mr. Henry C. Clark:

Q. Are these the accounts that you referred to?

A. No, sir.

[fol. 49] Q. Well, what are those accounts that I just

handed you?

A. One of them is the statement of the entries on the Nebraska corporation's books and ledger account, Union Pacific Stages of California-open account during the year 1936.

The other one is the detail of the monthly debits and credits made on the California books in the ledger account, Interstate Transit Lines-open account for the year 1936. They represent the same entries. They represent what was referred to on the direct examination as one of these open accounts, the open account other than the one that was limited to profit and loss.

Counsel for Respondent: We offer these, your Honor, as representing the other so-called open account that was referred to on direct examination.

Mr. Mann: No objection.

The Member: Let them be identified by the witness so that we may know what we are reading.

Counsel for Respondent: They may be offered jointly

as one exhibit.

The Member: Received as Respondent's Exhibit A.

(2 sheets received [anr] marked Respondent's Exhibit A in evidence.)

This paper that you hand me is a copy of the balance sheet of the Union Pacific Stages of California as of December 31, 1936.

Counsel for Respondent: We offer that in evidence.

Mr. Mann: No objection.

The Member: Received as Respondent's Exhibit B.

(Balance sheet received and marked Respondent's Exhibit B in evidence.)

These papers that you now hand me are a statement showing for Interstate Transit Lines, Union Pacific Stages of California and Interstate Transit Lines, Inc., the operating revenues, operating expenses, income and profit and loss for 12 months ended December 31, 1936.

Counsel for Respondent: We offer this in evidence. The Member: Received as Respondent's Exhibit C.

(Statement received and marked Respondent's Exhibit C in evidence.)

I obtained this item of \$28,100.66 shown on the profit and loss open account from the income account of the California [fol. 50] corporation, that is, not any of the accounts that have been offered here. I have that account here. There would not be a corresponding account on the accounting records of the Nebraska company. The account to which I have just referred is the income account in the general ledger of the California company and those figures come from another book. That figure, \$28,100.66, the loss for the year 1936, has a total shown in here which is the difference between the operating revenues and operating expenses for the year as reflected by this statement you have. That is Exhibit C. Exhibit B doesn't show the red and the black figures. In the photostatic copy the red and black figures can't be brought out. Balance sheet of the Union Pacific Stages of California as of December 31, 1936, which is the original document of which Exhibit B is a photostat. is the original document showing the red and black figures which are not reflected on the photostatic copy.

Note: A red ring was placed around the figures on the photostatic copies which are red on the original exhibit. In printing this red ring appears as a black circle.

The Witness: In answer to the question, these exhibits show that to December 31, 1936, that there is an accumulated profit on the books of the California company of \$47,512.18. The figure for the period ending December 31, 1935, is \$75,612.84.

Q. Now, that last figure represents money, does it not, in the bank account of the Nebraska Company?

A. Well, you could term it that for the simple reason that the Nebraska corporation in the first instance collected all the money.

Q. Is it not true that the accounting records of both the Nebraska company and the California company show that that amount was held for the account of the California company by the Nebraska company?

A. That the amount of money-

Q. That the \$75,000 item that you just referred to was held by the Nebraska company for the account of the California company.

A. I would say so, as I said a while ago, due to the fact that the Nebraska company in the first instance collected the money. Q. Again referring to Exhibits 3 and 4, which is this socalled operating account of profit and loss, is it not a fact [fol. 51] that that account is the only recognition which has been given between these companies of that profit and loss from year to year?

A. Yes, of the profit and loss figure.

Q. Has there ever been any final settlement between these two companies of any profit and loss as between themselves?

A. Settlement has been made through the open account.

Q. In other words, is it true that the only—that the most that has been done is the placing of these entries on the books of account?

A. Insofar as the profit and loss is concerned, yes.

Q. There has never been any cash settlement of any sort between the two companies, has there?

A. No, sir.

Q. And, as I understood your testimony, as of January 1, 1936, the California company's operations, according to the accounting which was kept, showed an aggregated profit of slightly over \$75,000?

A. Yes.

Q. And if there be deducted from that this deficit of slightly over \$28,000 for the year 1936, there would remain a profit balance at the end of 1936 of something over \$47,000, would there not?

A. I believe that is the correct figure. It is correct on the balance sheet there

Q. And nothing else was done between the companies except the entry of some figures on the books, was there, as to 1936?

A. No, sir, not with respect to the profit and loss item, no.

Q. Well, is this not true, that from the organization of the California company and its operation from year to year, through the year 1936, we find that because of the prest which it made during the early years that there always was shown on these records a profit balance in its favor?

A For each and every year prior to 1935 I couldn't testify because I don't have the record here. However, the figure is accumulative profit and loss up to the period shown.

[fol. 52] Q. And these reports show that as of December 31, 1936, there was a profit balance remaining of over \$47,000?

A. Yes, sir.

Q. So that, as a matter of fact, the Nebraska company was not called upon and did not in any manner advance to the California company the \$28,000 item of so-called deficit for 1936?

A. No.

Referring to this Exhibit C which shows under the first block the revenue items and then a series of blocks of various sorts of expense items, the item of passenger revenue is not apportioned on the bus mile basis. Intrastate passenger revenue earned within the State of California is assigned to the California corporation and California's proportion of the interstate revenue is allocated to California on the basis of the number of miles travelled by the individual passengers. The interstate is apportioned. You have an item of rent from equipment in the operating revenues which is not apportioned on the mileage basis. That represents the use of other companies' equipmentthe use of the California company's equipment on the properties of the other lines. The equipment rental which is shown here as being earned by the Nebraska company is the rent of Nebraska cars operated in California and Illinois territory. We keep an accurate accounting record of the mileage run by each bus for more reasons than one. There is no expense charge shown there for general office rent, the rent of the general offices in Omaha. Those offices are not in the office building of the railroad company in Omaha. The headquarters office of the bus line is owned by the Nebraska corporation. No rental apportioned is to either of the sub-companies. We use the railroad attorneys for convenience. If, in the operations of the Nebraska bus company we need legal advice, we go to the Legal Department of the railroad company and we are billed for that and pay the bills. The voucher or check is payable to the Union Pacific Railroad Company. Those bills are apportioned between the companies. We do not make any attempt to arrive at the income of the California company for passenger revenues, with the exception of the intrastate, other than by this mileage allocation basis. Those two items, partial checking and at the depots, I believe is assigned direct to the California corporation right there in the City of Los An-[fol. 53] geles. Now, looking at the expense items and taking first block one headed maintenance of building and grounds, those expense items are apportioned between the

companies insofar as there are any on the mileage basis. There don't happen to be any. Now, turning to block two, which is headed maintenance of equipment, those items are all allocated to the three companies on the proportionate mileage basis with the exception of the retirement items, and that is handled in conjunction with the accounting for depreciation.

Blocks three and four together, one being headed traffic expenditures and the other transportation expenses, are allocated between the three companies on a mileage basis. Under item 4, rent for equipment is not apportioned on a mileage basis.

Now block five, entitled general expenses, there are no items there which are not apportioned on the mileage basis between the companies.

We come to block six, depreciation. Depreciation is accrued on the books of the respective companies based on the depreciable property in the investment account and not apportioned on the mileage basis. In other words, each company is charged with the depreciation on that specific property which is found in its own individual investment account. What I referred to as depreciation accrual is what we term a charge to operating charge item. It is a deduction from operating item, crediting depreciation reserve.

An item here that stands in a line by itself just below this block six, the item to which I refer being entitled taxes. There is no apportionment between the companies on that item

Q. How is that item allocated between the companies?

A. Taxes assigned directly to the respective companies, accrued on the books.

Q. If the Nebraska company were to pay \$2,500 as income taxes for the California company, then that would be charged directly to the California company, would it not, in that amount?

A. It would be charged on that account.

Q. And it would be charged here as a charge to the California company?

[fol. 54] A. As having been accrued on the California

Q. And would that item include whatever taxes might be paid to the several states, income, excess profits, capital

stock taxes or Social Security taxes paid to the Federal Government and any license taxes paid to the states?

A. Yes, sir, I might state it this way, that it includes all taxes which are paid for account of the California company by the Nebraska company. Put it that way.

Q. You referred in your direct testimony, Mr. Hall, to capital expenditures made by the Nebraska company for the account of the California company. What did you mean

by that? Can you name some of those?

A. The reference there to capital expenditure, what I had in mind was the purchase of buses or shop machinery or any items which the California corporation capitalized. That is, they charged to capital investment account. The I. C. C. perhaps would call it additions and betterments, tangible assets.

Q. The purchase of tangible assets, that is what you really meant?

A. Such as cars.

Q. As a matter of fact you didn't undertake, I suppose now from what you have said, to classify any advances which the parent company might have made to itself, as not being a capital advance, did you?

A. Classified them as not being capital investment?

Q. Yes, you didn't mean to do that, did you?

A. No, sir.

Q. I will state another question. Has the Nebraska company at any time after the commencement of business of the California Company, found it necessary to advance to the California company a single dollar?

A. The Nebraska company has paid all of the bills of

the account of the California company.

Q. Did it not pay those bills out of the revenues which it had previously received which properly belong to the California company.

A. In making payments, I doubt if it's possible to ear-

mark a dollar for which payments are made.

Q. Isn't it true at the time revenues which the Nebraska company received during the entire time commencing with the beginning of the business of the California company and [fol. 55] continuing through the year 1936, that those revenues exceeded all disbursements which were made for the account of the California company?

A. I would say not.

Q. Will you tell us when that was not true?

A. The reason I state that is because in the beginning, in answer to your question, the California company started in 1932 and at the beginning the Nebraska corporation had to put up money to buy the two buses for the California company and it's a cinch that the California company hadn't any money at that time, hadn't accumulated or had been operating, so that the Nebraska corporation could not obtain any money from the operations in California, that is, a sufficient amount to cover the amount that they originally put up.

That is what I am getting at.

Q. Didn't the Nebraska company subscribe to all of the outstanding stock of the California company?

A. Yes.

Q. What did they give to that company?

A. It was in dollars and cents?

Q. Whatever it was.

A. That was handled through open account between the

two companies.

Q. Well, as a matter of fact, didn't the Nebraska company receive that stock because of whatever contributions that it made to the California company, either in cash or by furnishing equipment at the time the California company started business?

A. They paid for the stock through open account and also the investment that the California company originally acquired was handled through open account on the books of

each company.

Q. And was there any balance, one way or the other, after the stock account was completed? Did the California company owe the Nebraska company or did the Nebraska company owe the California company? I am speaking back to when the stock was issued.

A. Well, as I say, the Nebraska corporation, the acquisition of the California company stock, made entries on their books through open account for the so-called purchase of the stock.

[fol. 56] Likewise, California did the same thing in getting their stock issued.

Q. And they balanced one another, the stock against the advance?

A. Of course, in the beginning, in addition to the open account for the stock, Interstate Transit Lines also paid for the physical assets of the California corporation which was in excess of the amount of stock issued.

Q. But, as I understand you, as of December 31, 1935, the Nebraska company was \$75,000 to the good as shown by its books and the books of the California company because of the operations of the California company?

A. Yes, I believe that is the figure shown on the balance

sheet, as I recall it.

Q. And at the end of 1936, all that was done was to reduce that balance by the amount of this so-called \$28,000 deficit, is that true?

A. Yes, insofar as the profit and loss account is con-

cerned, that is true.

Q. Well, is there any way in which it is not true?

A. No, sir, because it was the profit and loss account

we are speaking of.

- Q. So that at the end of 1936, we find that the Nebraska company is still \$47,000 to the good, because of the operation of the California company as shown by the books, is that correct?
 - A. Not considering the open account, yes.
- Q. What do you mean the open account? You mean this Exhibit A?

A. Yes, sir.

Q. All right, you say not considering it. What would

it be if you do consider it?

A. At the end of December, 1936, the books of the California corporation show liability brought about by the aggregate of the open account and the net profits per operations of \$5,874.96.

Q. A liability to whom?

A. To the Nebraska corporation.

Q. Well, now, what gave rise to that difference? In other words, why is not the \$47,000 item shown on the open account of profit and loss correct? Why do you now modify

it to that \$5,000 item?

[fol. 57] A. That is the correct figure for the net profit from operations to December 31, 1936, but as I understood you to say that it be to the good, the Nebraska corporation would be to the good of that particular figure, I would say that the Nebraska corporation would not be to the good of that particular figure.

Q. And why?

A. For the simple reason, as I mentioned there, it takes the open account through which the current items are handled and the net profit from operations together making a net liability on the part of the California company.

Q. Well, is that open account, this item Exhibit A?

A. Yes, sir.

Q. What is there to cut down that \$47,000 item that represents what the Nebraska company is supposed to have been entitled to for the period up through 1936? What is there on this other open account item to cut that down?

A. Well, it's through that open account item, the first one, this one here (indicating), it's through the account Interstate Transit Lines—open account, that the open account entries are made on the California books.

The Member: And the open account to which you just referred, is that shown on Exhibit 4?

The Witness: Yes, sir.

Q. Mr. Hall, am I correct in understanding you then to say that in the first place, the Nebraska company, as shown by the profit and loss open account, was \$47,000 to the good as of December 31, 1936?

A. That is right, the net profit from operations December 31, 1936, on the California books shows a profit as of

December 31, 1936, of \$47,512.18.

Q. You referred to another open account item which, as I understand you, is in the sum of \$41,637.23, is that right?

A. That is right.

Q. And as I would understand you, by your looking at Exhibit B, this balance sheet, I would say that the lastmentioned item of \$41,000 odd is to be subtracted from forty-seven thousand odd dollars item?

A. That is correct.

[fol. 58] Q. And that would leave then under any conditions, that Nebraska corporation, at the end of 1936 was to the good, \$5,874.96, is that correct?

A. Yes, sir.

Q. And there is no exception to that, is there?

A. No. sir.

Q. Aside from the commencement of the California company business, in getting it going, did the Nebraska company ever advance a dollar to the California company?

A. Well, as I have testified before, the Nebraska corporation paid all the bills, paid all necessary expenses for investment, that is, buses, rents, taxes or what have you.

Q. But it paid them out of revenues, did it not, after the

business got going?

- A. Well, as I say, I think that that would be very hard to testify, due to the fact that the dollars are not earmarked.
 - Q. Did the Nebraska company pay any dividends?

A. The Nebraska company?

Q. Yes.

A. Certainly.

Q. Did it pay dividends each year down through 1936?

A. No, sir, you mean from commencement of the corporation?

Q. Yes.

A. It did not.

Q. Did it pay dividends in 1936?

A. Yes, sir.

Q. How about 1935†

A. Yes, sir.

Q. 19341

A. Yes, sir.

Q. 1933?

A. No, sir.

Q. 1932†

A. No, sir.

Counsel for Respondent: That will be all.

Redirect examination:

There has been some question about settlement of the two companies through inter-open accounts. Exhibit 4 shows [fol. 59] that on the dissolution of the California company there was a final settlement between the Nebraska corporation and the California corporation in 1940. That was in connection with the dissolution of the subsidiary company. The balance sheet of the California company at November 30, 1936, shows that at that date on the two open accounts, the California company owed to the Nebraska company seventy-five odd thousand dollars as a result of the completion of profit and loss settlements for prior years and at the same time, shows an indebtedness from the Nebraska company to the California company of \$41,000 on account of

Committee of the commit

open current account-cash open account, so that there was at that date a balance owed by the California company to the Nebraska company of \$34,124. In the open account on the Nebraska company's books with the California company, Exhibit A, the December items in that account show that the charges and debits to the cash open account in the month of December are both about \$17,000, so the open account varied less than a thousand dollars during the month of December. At the time I made the entry in Exhibit 4 on December 31, 1936, recording the \$28,100.66 loss of the California corporation, there was a balance owed by the California corporation to the Nebraska corporation of approximately \$34,000. So the effect of the entry which I made in Exhibit 4 of \$28,100.66 was to reduce the balance owed by the California corporation to the Nebraska corporation by \$28,100, and still left a balance owed by the California corporation to the Nebraska corporation of \$5,000. The California corporation had no bank account. The Nebraska corporation was its banker. There was no other way about which I am aware that the settlement between the two corporations could have been made other than by charging that open account.

Re-Cross Examination

There was never any final settlement between these companies prior to 1940, when the California company was dissolved.

[fol. 60] The limited stipulation of facts was submitted which the Member ordered to be filed and become a part of the record. The stipulation follows.

Dated January 7, 1942.

Henry W. Clark, Attorney for Plaintiff.

Nelson Trottman, Of Counsel.

APPROVAL OF STATEMENT OF EVIDENCE

No objection to the foregoing statement of evidence.

J. P. Wenchel, Atty. for Respondent.

Approved and Ordered Filed this 4-Day of February, 1942.

J. Russell Leech, Member.

STIPULATION OF FACTS

It is hereby stipulated and agreed by and between the petitioner and the respondent, by their respective attorneys of record, that the following facts and statutory provisions may be considered as true and correct in deciding the issues involved in the above proceeding; each party reserving the right to introduce other and further evidence not inconsistent herewith.

- (1) Petitioner was incorporated in 1928 under the laws of the State of Nebraska.
- (2) Union Pacific Stages of California was incorporated in 1930 under the laws of the State of California.
- (3) During the period from 1927 through the year 1936, California Statutes in their Public Utilities Act, Sec. 50-1/4, 1927 Statutes, page 74; Deering's General Laws of California, 1937 Edition, Act 6386, page 3161, provided as follows:
- [fol. 61] "No passenger stage corporation shall hereafter operate or cause to be operated any passenger stage over any public highway in this state without first having obtained from the railroad commission a certificate declaring that public convenience and necessity require such operation, but no such certificate shall be required of any passenger stage corporation as to the fixed termini between which, or the route over which, it is actually operating in good faith at the time this act becomes effective in compliance with the provisions of an act known as Chapter 213, Statutes of 1917 of the State of California, approved May 10, 1917, and amendments thereto, nor shall any such certificate be required of any person or corporation who on January 1, 1927, was operating, or during the year 1926 had operated a seasonal service of not less than three consecutive months duration, sightseeing buses on a continuous sightseeing trip with one terminus only."

Dated, New York, N. Y., January 16, 1941.

Henry W. Clark, Counsel for Petitioner; J. P. Wenchel, Counsel for Respondent.

PETITIONER'S EXHIBIT 1

This Agreement, made as of the seventh day of February, 1932, by and between Interstate Transit Lines, a corporation organized and existing under the laws of the State of Nebraska, (hereinafter called Transit Lines), party of the first part, and Union Pacific Stages of California, a corporation organized and existing under the laws of the State of California, (hereinafter called the California Corporation), party of the second part, Witnesseth:

Recitals: The California Corporation is a subsidiary of, and all of its capital stock is owned by, Transit Lines. Transit Lines operates busses between various points but operates no busses in the State of California. The California Corporation operates busses in the State of Cali-[fol. 62] fornia. The California Corporation is maintained as an operating subsidiary of Transit Lines and its operations are conducted solely for the benefit of Transit Lines. In order that Transit Lines may obtain the greatest benefit from the operations of the California Corporation it is necessary that the schedules of the California Corporation be coordinated with the schedules of Transit Lines, and that the California Corporation operate on such routes and upon such schedules as will most greatly benefit Transit Lines. Since such operation may not be so remunerative to the California Corporation as operation solely for its own corporate benefit, the parties hereto have agreed that during the term of this agreement such coordinated bus operation shall be carried on under the terms and conditions hereinafter set out.

Now, Therefore, the parties hereto mutually agree as follows:

First: The California Corporation agrees to operate busses upon such routes and upon such schedules, and under such operating rules and regulations, as may be directed by Transit Lines.

Second: Transit Lines agrees to assume and to reimburse the California Corporation for any deficits incurred by the California Corporation in its operations. The California Corporationagrees to pay over to Transit Lines any profits resulting to the California Corporation from its operations. Payments hereunder shall be made only at the end of each calendar year. The deficit or profit, however, shall be calculated for each calendar month separately.

Third: This agreement shall be effective as of the seventh day of February, 1932, and shall continue in full force and effect until terminated by notice as herein provided. Either party hereto may terminate this agreement on the last day of any calendar month by notice delivered on or before that day to the other party hereto.

In Witness Whereof, the parties hereto have caused this agreement to be executed by their respective officers there-[fol. 63] unto duly authorized, and under their respective corporate seals as of the date first above written.

Interstate Transit Lines, By R. J. Walsh, President.

Witness: A. C. Phillips.

Attest: C. B. Matthai, Secretary.

Union Pacific Stages of California, By R. J. Walsh, President.

Witness: A. C. Phillips.

Attest: C. B. Matthai, Secretary.

PETITIONER'S EXHIBIT 2

This Agreement, made and entered into this eighth day of February, 1932, by and between Interstate Transit Lines, a corporation of the State of Nebraska (hereinafter called "Transit Company"), party of the first part, and Union Pacific Stages of California, a corporation of the State of California (hereinafter called "Stage Company"), party of the second part, Witnesseth:

Recitals: The Transit Company has been operating a passenger motor coach transportation business from points east of Salt Lake City, Utah, through Salt Lake City and Las Vegas, Nevada, to Los Angeles, California, doing only an interstate business in the State of California. The Stage Company, a subsidiary of the Transit Company, contemplates engaging in certain intrastate motor coach operations in the latter state and it has been arranged between the parties hereto that the Stage Company, in addition to performing said intrastate operations, will take over as suc-

[fol. 64] cessor of the Transit Company all motor coach operations heretofore performed by the Transit Company in the State of California. The Transit Company will therefore terminate its motor coach operations at the California-Nevada State line and there connect with the motor coach lines of the Stage Company. For convenience and economy of operation, it is desirable that the buses of each party run through from its territory into the territory of the other party.

Agreement:

Now, Therefore, it is mutually agreed by and between the parties hereto as follows:

Section 1. The buses of the Transit Company operating from points north of the California-Nevada State Line shall on each trip continue through south of said State line, and at said State line shall pass into the custody and possession of the Stage Company. The buses of the Stage Company operating from points south of said State line shall continue through north of said State line, and shall pass into the custody and possession of the Transit Company at said State line. Each party shall during the term of this agreement, and hereby does, lease its buses to the other party while so in the custody and possession of such other party, subject to the terms and conditions hereinafter stated.

Section 2. The owning party is hereinafter for convenience designated as the "Lessor" and the party to which said buses are hereby leased is hereinafter designated as the "Lessee". The Lessee shall pay to the Lessor monthly a sum of money equal to Five Cents (5c) for each and every mile run by each bus of the Lessor while in the custody and possession of the Lessee. The Lessee shall bear and pay that portion of the expense of maintaining and operating said buses (other than drivers' wages and taxes) and of insurance thereon, including fire, public liability and property damage, which is properly attributable to said buses while in its possession. The drivers of the buses involved in this agreement shall be the sole employes of, and their wages shall be paid by, the Lessee while such drivers are in service in connection with leased buses in the custody [fols. 65-66] and possession of the Lessee. Each party shall pay taxes on its own buses. Adjustments of accounts as

between the parties hereto shall be made monthly as soon after the first of each month as practicable.

Section 3. The Lessee shall be responsible to the Lessor for the buses of the Lessor while in the Lessee's custody and possession.

Section 4. This agreement shall take effect on the date first herein written and shall continue in full force and effect until terminated by written notice given by either party hereto to the other on any date in such notice stated not less, however, than thirty (30) days subsequent to the date on which such notice shall be given.

In Witness Whereof, the parties hereto have caused this agreement to be executed in duplicate as of the date first herein written.

Interstate Transit Lines, by R. J. Walsh, President.

Witness: John A. Bennewitz. (Seal.) Attest: C. B. Matthai, Secretary, ITL.

Union Pacific Stages of California, by R. J. Walsh, President.

Witness: John A. Bennewitz. (Seal.) Attest: C. B. Matthai, Secretary, UPSOC.

Approved as to form: John A. Bennewitz, General Attorney.

319 U.S. 590 U.S. Sup. Ct. Records, Briefs 1942, no. 552 Card 2 (of 6) Interstate Transit Lines v. Comm. of Int. Rev. Record.

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INTERSTATE TRANSIT LINES vs. COM-MISSIONER - Docket No. 101692

RESPONDENT'S EXHIBIT "A" INTERSTATE TRAFFIT LIVES

1.6

Lodger Account - Union Pacific Stages of California - Open Account

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United PACIFIC STATES OF CALIFORNIA 1016

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EXHIBIT "A" - (Fage 2)

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UNION PACIFIC STAGES OF CALIFORNIA INTERSTATE TRANSIT LINES, INC.

OPERATING REVENUES, OPERATING EXPENSES, INCOME, AND PROFIT AND LOSS,

ACCOUNTS	Union Pacific Interstate Interstate Thes							
ACCOUNTS	Stages of California	Inc.	Treasit	Amount	Dec -Red	Per		
OPERATING REVENUES								
1. Projekt Revenue								
1. Prospect Revenue	161 147.32	26 2 145 .39	1747 358.9E	3471 341.52		4.37		
1 Euro Beggge Revenue	دا دين	340.78	\$ 925.92	6 17: 65	1 33.04	42.65		
4. Mail Revouse			256 4	434 90	7	190		
A Package Revision	579	. :1 8	Ju h	1 472 16	2	14 17		
4. Other Passager Service Revenue	2 117,.15	103 1	16 395.04	1: 50% 72	1 1:0	1 :2		
7. Charter Service Revenue				22 35, 13	1. 12: **	40 32		
1. Revence Ressived from Referends under Contract	17. 39	1 2. 7	1 635.23	34 7:3 .	C2	1: 93		
A. Commissions from Tiebet Sales	. 082.83	14	A :37 99	61 985	11.58	1.14		
M. Pured Cheshing and Storage Revenue	377 30	1. 10	12 593 67	10 9F4 .7	3 40.	1. 1		
	21: 44	2'6 ':	10 432.19	12 648 '4	67	31.49		
11. Station, Bus and Garage Concresions			14.41	314 61	232 87	6.00		
12. Rest from Buildings and Other Property	12 073 76	55 248 27	14 9 941 .37	211 263 40	11 426.84	5.20		
13. Rest from Equipment	5 00	14.64	3 5/7 30	3 446 34	. 14	7 33		
H. Missilanova Reverse		341 983 78		3997 MX 32	73 - 2.71	2 87		
Total Operating Reversion	183 365,60	301 303 76	3472 494.59	3101 772 73		- 07		
WHATEO EXPENSES:								
L MANYSMANCE OF BUILDINGS AND GROUNDS						-		
18-1. Balestes of Officers								
M.S. Salaries of Clorks and Attendants		-						
15-2. Office Bessie								
18-4. Traveling and Office Expenses	•	•						
Stal Description	•	•				-		
M. Acasim to Gorage and Shop Buildings	141 16	521 12		3 1.	77.56	1 14		
17. Repairs to Day Depots and Terminal Buildings	255 60	434 67	4 525 59	21 43. €	7 5			
N-1. Retirements - Buddhare						•		
18-8. Betherments—Office and Agrocy Equipment	-		-		4: 34			
14. Retirements—Misselesson					-			
Said Bellemonts			-	-	72.75	-		
1. Other Melatanese Errorese			-			-		
	\$17.7C	141.52	7 447 74	3 2 - 26	600.80	7 38		
Total Maintenann of Dublings and Orestale		-				-		

	-1	1	1			
EL MANTHEAMOR OF ROUTPAINT					10.0	
#6-1. Balantee of Officers				1	.12.50	
26-8. Salustes of Chesia and Attendents	35" .6	567 71	· .2. *.	* 3531		
SS-8. Office Rents					•	•
26-4. Traveling and Office Expenses	18.3	28.30	122.42	369.09	₹ ?3	
Total Reportation from	354.75	576.02	6 752.14	7 732.7:		
St. Repairs to Machinery, Tech and Equipment	\$50.47	405.03	6 382.25	2 24" . "1	572 57	11.
SF-1. Thro and Tubes	6 839 34	10 811.33	119 711.62	137 162.35	11 9 35	34
SF4. Wage of Shapman	7 861 81	12 149.05	137 519 40	157 510 26	10"1	2.60
37-8. Our Repoir Motorials, Supplies and Expenses	7 :13.77	11 8:1.74	133 392 52	152 818 03	03.47	2.12
SF-4. Shop Expenses	682 01	1 050.78	11 340.50	13 673 41	1 092 33	7.10
SF-6. Outside Repairs to Care	411.54	634.18	7 171 14	8 235 46	. 133.92	
Total Repairs to Motor Constan and Passes	23 384.49	36 EST 15	409 755.18	469 4 70 :	. 177.59	
20-1. Thus and Tubes	38 86	31.89	1 036 34	1 7 27	251.22	26 84
28-8. Wegas of Beganes					•	
28-4. Car Repair Meterials, Supplies and Expenses	12.90	142.33	: 625.51	1 860 02	577.71	14.26
28-4. They Expenses					•	
25-8. Outsido Bepoise to Com	28.41	44,72	499.94	573.08	26.41	4.83
Solal Repairs to Strades, Automobiles and Tractors	180.26	278.74	3 161.77	3 520.99	848,54	
20-1. Rethumento-Motor Condon and Busss	•		7 .7.81	3 508.31	60 756.62	
M.C. Rethuments-Trucks, Automobiles and Tructors			5.5.2	156.00	579.94	
29-8. Retirements - Machinery, Tools and Equipment					•	
Total Retirements	•	-	3 364.41	3 964.41	41 334, 38	31.35
38. Injectos to Pensons	128.31	132.02	2 147.72	2 461.05	1 529.45	-
21. Other Melatenesse Reposes	711.22	478.61	5 377 34	6 167.95		13.60
Total Maintenance of Squipment	₩ 553 4€	38 207 95	427 805 59		34 754.97	7.62
III. TRAFFIC EXPENSES						
86-1. Relates of Officers	265 44	411.58	4 445. 18	5 342 10	352 ao	7.07
86-6. Balactos of Clarks and Attendants	2 379 68	\$ 685.96	61 785 71	47 3:4 35	5 220.47	
86-4. Office Rents	43,43	67.67	758 93	237 .	.620.00	41.33
85-4. Thereing and Office Expenses	970 31) 505 42	17 148.99	19 633.72	2 137.33	12.22
Total Aspertational and Additional	3 564 75					
St. Advertises		2 844 HZ	64 3"! "8	73 YIC. 47	7 370.80	
Sf. Other Traffic Repenses	53 13	8 200 84	346.53	084.54	1 3/4.50	3.76
Said Staffs Species			140 483 54	180 994 20	10 001 80	4 49
W. Therefore Expenses				100 101 00	10 /// 10	
6-1. Belatin of Officers	1 634 73	2 529.23	26 624 34	32 790.30	2 203 31	* 35
66-6. Salaries of Clarks and Attendants	777 BC	1 204 .71	13 649 35	15 :: 3 94	1 003 15	03
64 Ofer Park		- 33				
60-4. Office Repts 60-4. Thronday and Office Reposites	322.74	1/3 24	5 127	42 76	1 271 /	25 20
49-4. Operation let Desires Chap	7. 71	72. 34	20 29	: 599 33		
Said Papartein Lang	2 849 . 70	6 363.63	49 298 64	36 453 45	3 377 41	
	. 551.70	1 000.00	47 610 00	20 403 43	9 9. 41	0, 101

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[fols. 79-80]

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INTERSTATE TRANSIT LINES UNION PACIFIC STAGES OF CALIFORNIA INTERSTATE TRANSIT LINES, INC.

OPERATING REVENUES, OPERATING EXPENSES, MICOME, AND PROFIT AND LOSS,

	Union Pacific	Interstate	Interstate	This Tear		
ACCOL STR	Biages of California	Transit Lines	Typesit Lines	Amount		2
IV. TRANSPORTATION EXPENSES (Continued)						
41-1 Salanes of Station Employes	6 819 33	10 554.64	119 401.95	136 075.40	8 006.36	6.21
41-2 Commissions Paid Agents	1 .12.44	18 54 44	208 323.55	238 808.33	12 846.04	5.10
42-1 Rent for Stations	-, 7 .)2	10 31: 73	117 731.75	134 to4.76	13 790.70	11.39
42-2 Other Station Expenses	1 4 - 45	2 79% 45	26 091.35	29 671,46	591.08	2.02
Total Station Expenses	. 1 34	41 792 /1	171 647, 13	540 378,95	9 544, 24	1.00
43 Rent for Equipment		74 237 65	136 44	239 637,81	12 353.02	5.44
14 Wages of Drivers	1	19 872 5.	449 820.64	515 300,03	40 994.77	3.44
4) Gawiline	11 400 12	2 :13.95	337 225.18	386 433,35	21 494.89	5.89
46 Lubricants .	1 325.43	2 836.14	32 081.40	36 744.03	1 733.02	4.50
47 Other Supplies for Equipment	54r 45	: 82.34	11 263.69	12 072.40	847.85	6.18
48 Garage Expenses	4 100.38	7 337.00	83 298.96	95 396.12	6 710.05	6.57
49 Service Equipment Operation	30 14	123.04	1 397.53	1 600.76	250.40	19.34
41 Payments to Railroads Emergency Service	129 46	432.36	5 A75.51	6 237.73	309.60	3.48
I less and Damage Baggage	: 4 73	193 65	2 1 06 .60	2 505.03	424.68	13.26
12 Injunes to Persons	. 55	279.97	3 173.24	3 632.00	640.97	21.42
id Otter Fransportation Expenses	3-9 44	2 137.73	24 223.50	27 750.07	616.10	3.87
Total Transportation Expenses	1-1 311 03	204 477 .98	15"3 847,41	1025 036.42	80 896,76	
V. ORNERAL EXPENSES						
1611 Silanes of General Officers	1 4"2.2"	2 250.75	25 05. 18	29 605.80	42.66	1.29
146.2 Expense of General Officers	127.55	660.43	7 493.45	8 581.83	3 117.41	26.65
Total Salaries and Expenses of General Officers	1 699.62	2 940, 96	33 366,43	26 157.65	2 454.75	1.04
61-1 Salaries of Clerks and Attendants	3 433.22	5 319.36	60 302.69	61 063.87	1 100.50	1.01
61-2 I ye nees of Clerks and A tendants	17.32	28.16	304.77	254,25	14.07	4.03
Total Salaries and Expenses of Clerks and Attendants	3 450.54	5 347,52	60 411.46	69 400.50	3 345.43	3.37
651 Ceneral Office Rents		••	•	•	•	•
62.2 Other General Office Exprises	142.52	202.16	3 204.17	3 444,86	1 000.66	•
Total General Office Expenses	182.52	242.16	3 204, 19	3 444.86	1 000.46	•
63 Law Expenses	4:6 37	769,79	8 718.65	9 945.03	3 Y43.48	8.4
64 Stationery and Printing	965.44	1 499, 38	16 897,70	19 362.58	2 621.56	15.66
6: Other General Expenses	274.38	422.47	4 780.46	5 406.53	545.40	1.34
66-1 Fire Insurance - Buildings and Contents	132.75	159.12	1 802.14	1 664,00	.53	•
66-2 Fire Insurance on Equipment	270.46	421.12	4 797.89			12.42
66-3. Personal Injury and Property Damage Insurance	5 529 89	8 587.93	16 808, 92		3 404.05	1.m
66-4 Fidelity and Burgiary Insurance	39,94	60.96	700.20		35.06	7.47
66-5. Workmen's Compensation and Other Insurance	80.00	130,20	1 354.97		343,40	
Total Insurance	6 031,00	9 307.33	105 422,52		4 750,40	13.70
Total General Expense	13 300.75	20 589 43	231 191.00	307 122.10	170.0	1.
TOTAL OPERATING EXPENSIS (End. Depreciation)	194 667.32	277 946.45	2399 672.10	1872 10L.07	120 004.40	4.54

TOTAL OPERATING EXPENSIS (Esci. Depreciation)	194 667.12	277 946,45	2399 672.10	2000 000 00	-	
VI. DEPRECIATION		4// 240,53	2344 61 E M	2672 206,07	33,070,62	4.
70-1 Depreciation - Buildings		_	12 631.70	30 403 00		
70-2 Depreciation - Furniture and Fixtures	244.32	244.59	6 667.22			4.1
70-3. Depreciation-Motor ('ourbre and Buses	4 245,94	14 013 72	143 040.36			4.
70-4. Depreciation Trucks, Automobiles and Tractors			2 602.85			23.
70-5. Depreciation-Machinery Tools and Equipment	308.40	115.00	5 640.40			34.
70-6. Depreciation—Improvements on Leased Buildings		413.14				
Total Depresiation	4 795,66		4 180.20			1
TOTAL OPERATING EXPENSES (Incl. Depreciation)		14 184 53			30 696,30	88.
AXES	199 462,99				240 775.22	1
	12 207,42		392 370.74	490 787.80	42 000.30	1
TOTAL OPERATING REPERSES (Incl. Depreciation and Tuess)	211 470.59	327 482.12	2047 ANS 97	3406 750.30	100 100.00	
NET INCOME PROM OPERATIONS	28 104,99	24 101-44	504 689.08	201 444.00	344 225.96	16
THER INCOME AND CHARGES - NET	4.38	9.32	2. 130.39			
BT DIOCES	28 100.66					
BOFT AND LOSS ACCOUNTS HET ALL MANY AND LOSS AND LOSS	- 4	25 520.66	527 543,61		246 006-62	1
HET PROFIT (Mark) or DEFICIT (Red)			2 439,17		1 40.6	•
TATISTICS:	28 100.66	24 510.46	525 104.44	. 521 534.46	347 704.65	11
Average Miles of Routes Operated		***				
Revenue Motor Coach Miles	744 780	611	5 154	5 000	97	
Revenue Passengers Carried			12990 007	14003 346	103 063	1.
Gasoline-Gallons Consumed	66 300	800 110	2162 430	2290 676	190 200	0.
-Motor Coach Miles Per Gallon	169 274	242 143	3063 349	3396 386	66 236	1
-Average Price Per Gallen (Centa)	4.39	4.39	4.39	4.30	.34	3.
Number of Coaches Owned	11.40	11.39	11.30	11,30	.41	3.
Average Number of Coaches Operated Daily	3		230	269	7	1.
Maximum Number of Coaches Operated	3	18	144	145		3.
Total Days all Conches were Operated	34	58	273	287	22	
Average Miles Run Daily For Motor Coach Operated	2 929	6 146	52 776	13 233	3 200	2
The same of the second comme of the second	253,4	178,8	246,3	279.0	16.8	

'Auditor's Office Jeavery 204 188. 7

Hote: Amounts reported herous for Assount 2, "Thursday Revenue" and 7, "Chapterforvine Revenue" are based on Mahet other and thursday will not agree with the total revenue reported for the month on Form 600 which is based on Melody between. 13 Bullion

[fol. 81] Before United States Board of Tax Appeals

PRAECIPE FOR TRANSCRIPT—Filed February 2, 1942

To the Clerk of the United States Board of Tax Appeals:

You Are Hereby Requested to prepare and certify and transmit to the Clerk of the United States Circuit Court of Appeals for the 8th Circuit, as the record on petition for review heretofore filed by the petitioner in the above entitled case, the following:

1. Docket entries.

2. The following portions of the petition:

The first paragraph thereof and the paragraphs num-

bered I, II, III.

Under Paragraph IV entitled "Assignments of Error", the first subparagraph and the second subparagraph marked A.

Under Paragraph V entitled "Facts", the first unnumbered subparagraph and the subparagraphs marked 1, 2, 3, 4, 5, 6, 7, 8 and 9.

Paragraph VI and the prayer for relief.

The following part of Exhibit "A": The deficiency letter and the "Statement", first 8 lines containing the tax liability (being all of pages 11 and 12, except the last two lines,

of the petition).

On Page 14 of the petition the title "Explanation of Adjustments" and thereunder subparagraph b (being lines 9 to 14 inclusive on Page 14) and the computation of tax, being the last 15 lines of Page 14. Exhibit "B". Note that this Exhibit "B" is omitted here but is included as "Petitioner's Exhibit 1" with the Statement of Evidence. Exhibit "C". Note that this Exhibit "C" is omitted here but is included as "Petitioner's Exhibit 2" with the Statement of Evidence.

- 3. The following portions of the answer: The first paragraph thereof and the paragraphs marked I, II, III, IV and of V, subparagraphs 1, 2, 3 to 6, 7, 8 to 13; the unnumbered [fol. 82] paragraph after subparagraph 19 and the prayer for relief.
 - 4. Findings of fact and opinion of Board of Tax Appeals.

5. Decision of the Board of Tax Appeals.

6. Petitioner's motion for reconsideration and the denial thereof.

7. Petition for review of the Board of Tax Appeal's deci-

sion by the United States Circuit Court of Appeals.

8. The Statement of Evidence with petitioner's Exhibits 1, 2, 3 and 4 (petitioner's Exhibits 1 and 2, being Exhibits B and C attached to the petition) with respondent's Exhibits A, B and C attached thereto, when the same shall have been settled by the Board.

9. This praccipe.

Dated: November 28, 1941.

Henry W. Clark, Attorney for Interstate Transit Lines. Nelson Trottman, Of Counsel.

[fols. 83-86] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 87] United States Circuit Court of Appeals, Eighth Circuit, May Term, A. D. 1942

No. 12,247

INTERSTATE TRANSIT LINES, Petitioner,

VS.

COMMISSIONER OF INTERNAL REVENUE, Respondent

On Petition to Review Decision of United States Board of Tax Appeals

Opinion-July 31, 1942

Mr. Nelson Trottman (Mr. Henry W. Clark and Mr. Joseph F. Mann were with him on the brief) for Petitioner.

Mr. Frederic G. Rita, Special Assistant to the Attorney General, (Mr. Samuel O. Clark, Jr., Assistant Attorney General, Mr. Sewall Key and Miss Helen R. Carloss, Special Assistants to the Attorney General, were with him on the brief) for Respondent.

Before Sanborn, Thomas and Riddick, Circuit Judges

[fol. 88] Thomas, Circuit Judge, delivered the opinion of the court:

In its income tax return for 1936, the petitioner, Interstate Transit Lines, claimed a deduction in the amount of \$28,100.66 as a loss sustained by its wholly owned subsidiary, Union Pacific Stages of California, and absorbed by the petitioner under a contract. The Commissioner disallowed the deduction "for the reason that no provision of the Revenue Act of 1936 authorizes such a deduction" and assessed a deficiency in the amount of \$4,461.53. The Board of Tax Appeals affirmed the determination of the Commissioner on the ground that the petitioner had not sustained the burden of establishing that the loss of the subsidiary was an ordinary and necessary expense of the parent corporation within the meaning of the applicable statute, § 23(a) of the Revenue Act of 1936, c. 690, 49 Stat. 1648, (44 B.T.A. 957). This statute provides that in computing net income there shall be allowed as deductions "All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business."

The taxpayer's petition to review presents the question of whether under the circumstances present the taxpayer, having pursuant to the obligation of a contract paid the operating deficit for 1936 of its subsidiary corporation, is entitled to a deduction on its income tax return therefor as an ordinary and necessary business expense. The inquiry calls for a brief review of the facts giving rise to the problem.

The petitioner is a corporation created under the laws of Nebraska with its principal office at the city of Omaha. Since 1929 it has operated interstate bus lines between Chicago, Illinois, and Los Angeles, California, for the transportation of passengers, mail and express. It had also acquired the right to handle intrastate business in the states [fol. 89] of Iowa, Nebraska, Kansas, Colorado, Wyoming, Utah and Nevada.

Prior to 1937 the petitioner could not acquire the right to do intrastate business in California, because during the period from 1932 and continuing through 1936 the Public Utilities Act of California, Section 50¹/₄, Deering's General Laws of California, 1931, Act 6386, page 3561, provided that

"No passenger stage corporation shall hereafter operate or cause to be operated any passenger stage over any public highway in this state without first having obtained from the railroad commission a certificate declaring that public convenience and necessity require such operation

and the railroad commission of California refused to grant certificates for intrastate operations to foreign corporations.

For the purpose of augmenting its income by means of additional revenues derived from carrying California intrastate traffic, the petitioner in 1930 organized under the laws of California the above named wholly owned subsidiary corporation, hereinafter called the subsidiary. Before 1932 the subsidiary had obtained the necessary certificate authorizing it to carry on the desired intrastate operations.

Having thus arranged to carry on both interstate and intrastate business in California the subsidiary and the petitioner in furtherance of the petitioner's purpose and plan entered into two contracts dated February 7 and 8. 1932, respectively. In the record the first contract is referred to as the Absorption Agreement and the second as the Operating Contract. The absorption agreement recited that all the capital stock of the subsidiary is owned by the petitioner; that the petitioner operates busses between various points but operates no busses in California: that the [fol. 90] subsidiary operates busses in California: that the subsidiary is maintained as an operating subsidiary for the sole benefit of the petitioner, and that to secure such benefits it is necessary that the schedules of the two corporations be coordinated. The agreement then provided that the subsidiary agreed to operate busses upon such routes and schedules and under such rules and regulations as may be directed by the petitioner. There was a further stipulation that petitioner would reimburse subsidiary for any deficits incurred in its operations and that subsidiary would pay over to the petitioner any profits resulting from its operations, payments to be made at the end of each calendar vear.

The operating contract recited that the petitioner had been operating a passenger business from points east through Las Vegas, Nevada, to Los Angeles, California, doing only an interstate business in the state of California; that the subsidiary contemplated engaging in intrastate operations in the latter state, and that the parties had arranged that the subsidiary would take over as successor all of petitioner's operations in California; that petitioner

would terminate its operations at the California-Nevada state line and there connect with the lines of the subsidiary; and that for convenience and economy it was desirable that the busses of each party run through from its own territory into the territory of the other. It was agreed that as the busses of each party crossed the state line they would pass into the custody of the other party; that as one party took possession of the busses of the other under this arrangement the owner should be designated lessor and the other party lessee; that the lessee should pay the lessor five cents per mile for each mile the bus was operated while in lessee's possession; and that the expense of operation should be apportioned between the parties [fol. 91] monthly, except that each party should pay the taxes on its own busses and that the lessee should be responsible to the lessor for the busses while in the lessee's

custody and possession.

There was no change in the conduct of the business after the parties began operating under the latter contract except that intra-California business was available on the busses when operating within that state. No additional expense was incurred other than the cost to the petitioner of keeping the separate accounts for the subsidiary. Both corporations had the same officers and directors. Both contracts were executed for each party by the same person as president of each company. The subsidiary had its own accounting records, employees, busses, directors, and corporate minute book. Its accounting records were kept at the offices of the petitioner by the employees who kept the petitioner's The petitioner collected all the revenues of the subsidiary and paid all of its bills. The subsidiary had no separate bank account. The revenues and expenses of both corporations were apportioned monthly on their respective books on the basis of passenger and traffic miles. Corresponding accounts, designated "cash accounts", showing the monthly apportionment were kept on the books of each party. Likewise there was kept in the books of each party a "clearing account" for an entry at the end of each year showing the absorption by the petitioner of the profit or deficit for the year resulting from the operation of the subsidiary.

For the calendar year 1936 the subsidiary incurred an operating deficit of \$28,100.66 as shown by its books. At the end of the year this amount was charged to the petitioner in the clearing account of the subsidiary and credited to the subsidiary in the clearing account of the petitioner.

[fol. 92] At all times the accounts of both corporations

were kept on an accrual basis.

The petitioner contends that in computing its 1936 income it is entitled to deduct as an ordinary and necessary expense the item of \$28,100.66 representing the deficit of its California subsidiary for that year. Briefly the basis of this contention is (1) that the subsidiary was the agent of petitioner in carrying the interstate traffic in California, hence the total expense including the deficit was an ordinary and necessary expense of petitioner; (2) that the payment was made in performance of a contractual obligation; and (3) that because of the close integration of the two corporations the subsidiary must be considered only an instrumentality or a department of the petitioner's business, on the principle that substance and not form should govern in order to schieve equal equity.

As a foundation for these contentions it is argued (1) that the total expenses allocable to carrying the interstate traffic in California would, with the exception of the cost of bookkeeping, have been the same as it was for carrying both the interstate and the intrastate traffic, and that equivalent expenses would have been borne by petitioner had the subsidiary not been organized and the absorption contract made; (2) that the deduction is not claimed merely because petitioner owned all the stock of the subsidiary; and (3) that the formal separate corporate entities should

under the circumstances be disregarded.

The Board held that the petitioner failed to sustain the burden of establishing that the accrual was an ordinary and necessary expense of the petitioner for the reasons, in part, (1) that the subsidiary was a separate, juristic taxable entity, and that its business in California was not the business of the petitioner; (2) that there is no evidence of [fol. 93] the ordinary and necessary expense of furnishing interstate transportation within the state of California, so that it cannot be determined whether all of the operating deficit of the subsidiary for the taxable year was attributable to the intrastate business of that company; and (3) that the subsidiary was not created nor the deficit made to increase the profits of the business of the petitioner. These things were done to augment the petitioner's income by increasing

the income of its subsidiary from revenues derived from the intrastate business in which the petitioner could not engage. Under these circumstances the Board held that payment of the deficit by the petitioner was in the nature of a capital expenditure and not an expense of carrying on the petitioner's own business.

In determining whether the Board erred in holding that the petitioner failed to sustain the burden of establishing that the payment involved was an ordinary and necessary business expense of the petitioner we must consider whether as a matter of law the evidence compels the conclusion that the payment was a business expense rather than a capital

expenditure.

The petitioner's first two contentions are in effect parts of a single argument. Stated briefly the substance of the contentions is that carrying interstate traffic in California was a part of the petitioner's business; that the petitioner employed the subsidiary as its agent to carry its interstate traffic in California, and that as part consideration for such service it agreed to pay the subsidiary's deficits, if any; and, therefore, the payment of the 1936 deficit was an ordinary and necessary contractual business expense. In this statement of the petitioner's contentions we accept the theory that the expense of carrying intra-California traffic may be disregarded as insignificant. Even so, the argument ignores the facts. Assuming that the subsidiary was [fol. 94] an agent of the petitioner as a carrier of its interstate traffic in California, the absorption contract obligating the petitioner to pay the subsidiary's deficits does not place the obligation upon the ground of payment for any service rendered or to be rendered by the subsidiary. The amount of the deficit to be paid is not made dependent upon any corresponding unit of benefit to the petitioner or sacrifice of the subsidiary. In fact revenues of the respective companies were apportioned monthly "on the basis of passenger and traffic miles, compared to the aggregate of the same." The deficit of 1936 was consequently an incident attributable wholly to the business of the subsidiary. Standing alone the fact that payment was the result of a contractual obligation does not render it an ordinary business expense. Deputy v. du Pont, 308 U.S. 488.

It is next argued that the close integration of the petitioner and of its subsidiary makes clear the fact that the subsidiary was but an agent or instrumentality of the petitioner: that the business of the subsidiary was but a department of the petitioner's business; and that, therefore, the corporate entity of the subsidiary should be disregarded for tax purposes. In support of this thesis reliance is placed upon such cases as Southern Pacific Co. v. Lowe, 247 U. S. 330: Gulf Oil Corporation v. Lewellyn, 248 U. S. 71; North Jersey Title Insurance Co. v. Commissioner, 3 Cir., 84 F. 2d 898: United States v. Brager Building & Land Corp., 4 Cir., 124 F. 2d 349; and Inland Development Co. v. Commissioner, 10 Cir., 120 F. 2d 986. These cases cannot be regarded as laying down any general rule authorizing disregard of corporate entity in respect of taxation. present peculiar situations and were determined upon consideration of them. Burnet v. Commonwealth Imp. Co., 287 U. S. 415, 420; American Package Corporation v. Commissioner, 4 Cir., 125 F. 2d 413, 415. The cases relied upon are not controlling here.

[fol. 95] The subsidiary in this case was organized primarily to do a business which the petitioner had no authority to do, and was used to carry on an active business for profit.

The general rule applicable to such cases was stated by Mr. Justice Van Devanter, speaking for the court in New Colonial Co. v. Helvering, 292 U. S. 433, 440, wherein he said: " * the statutes have disclosed a general purpose to confine allowable losses to the taxpaver sustaining them, i. e., to treat them as personal to him and not transferable to or usable by another." In Higgins v. Smith, 308 U. S. 473, 477, construing its own decision in Burnet v. Commonwealth Improvement Company, supra, the Supreme Court said specifically that, "A taxpayer is free to adopt such organization for his affairs as he may choose and having elected to do some business as a corporation, he must accept the tax disadvantage." But the government "may sustain or disregard the effect of the fiction as best serves the purpose of the tax statute." In Watson v. Commissioner, 2 Cir., 124 F. 2d 437, 439, the court held the language of the Higgins case, supra, to be conclusive. This court has recognized the rule as binding and followed it in Helvering v. Jane Holding Corporation, 8 Cir., 109 F. 2d 933, 943, and in United States v. Donaldson Realty Co., 8 Cir., 106 F. 2d 509. Compare Webber v. Knox, 8 Cir., 97 F. 2d 921, 923; Commissioner v. Trustees of Lumber Inv. Ass'n, 7 Cir., 100 F. 2d 18, 28; Planters' Cotton Oil Co. v. Hopkins, 5 Cir., 53 F. 2d 825, 827; New Colonial Co. v. Helvering, 292 U. S. 435. 441; In re Collins, 8 Cir., 75 F. 2d 62, 64; United Light & Power Co. v. Commissioner, 7 Cir., 105 F. 2d 866, 878; and Consumers Const. Co. v. Commissioner, 1 Cir., 94 F. 2d 731, 734.

The Board correctly applied the law to the facts. The corporate entity of the subsidiary cannot be disregarded, nor the "tax disadvantage" resulting from its organization avoided. *Higgins* v. *Smith*, *supra*.

[fol. 96] We also agree with the Board that the payment by the petitioner of the deficit of the subsidiary was a capital expenditure, not an ordinary and necessary expense of the

petitioner's business.

The conditions which distinguish a capital investment from an ordinary and necessary business expense in cases where a stockholder contributes something to his corporation have been settled, not by unanimity of decision but by clear weight of authority. If the contribution (1) is a benefit to or has value to the stockholder and (2) becomes an asset of the corporation when transferred to it, the stockholder increases his capital investment in the corporation, and the payment is not a deductible business expense. Whether such payment was made by reason of a contractual

Welch v. Helvering, 290 U.S. 111; Athol Mfg. Co. v. Commissioner, 1 Cir., 54 F. 2d 230; Menihan v. Commissioner, 2 Cir., 79 F. 2d 304, 306, cer. den., 296 U. S. 651; Atlantic Coast Line R. Co. v. Commissioner, 4 Cir., 81 F. 2d 309, cer. den., 298 U. S. 656, rehear. den., 298 U. S. 691; United States v. Donaldson Realty Co., 8 Cir., 106 F. 2d 509; Jenkins v. Bitgood, 2 Cir., 101 F. 2d 17; In re Park's Estate. 2 Cir., 58 F. 2d 965, 966; Pennsylvania Indemnity Co. v. Commissioner, 3 Cir., 77 F. 2d 92; Burns v. Commissioner, 5 Cir., 31 F. 2d 399, cer. den., 280 U. S. 564; First Nat. Bank in Wichita v. Commissioner, 10 Cir., 46 F. 2d 283. See also Commissioner v. Hadley, 2 Cir., 75 F. 2d 485, 487; Kistler v. Burnet, App. D. C., 58 F. 2d 687; Hamlen v. Welch, 1 Cir., 116 F. 2d 413, 419; American Cigar Co. v. Commissioner, 2 Cir., 66 F. 2d 425; Newark Milk & Cream Co. v. Commissioner, 3 Cir., 34 F. 2d 854; Newspaper Printing Co. v. Commissioner, 3 Cir., 56 F. 2d 125. Cf. Wiggins v. Commissioner, 1 Cir., 46 F. 2d 743; Shiman v. Commissioner, 2 Cir., 60 F. 2d 65; New York, C. & St. L. R. R. Co. v. Helvering, App. D. C., 71 F. 2d 956; Hill v. Commissioner, 1 Cir., 38 F. 2d 165, 168.

obligation or was merely a voluntary act does not affect the result.

In this case payment of the deficit was made for the sole benefit of the petitioner, and the contribution became an asset of the subsidiary. The subsidiary had no purplus. Under the absorption agreement all the profits earned by it during the preceding years of its existence, amounting approximately to \$75,000, had been paid over to the petitioner. Payment by the subsidiary of its \$28,100.66 operating deficit for 1936 would have impaired its capital to that extent. Payment of this sum by the petitioner was equivalent to a contribution of capital assets to the subsidiary, [fol. 97] made to maintain the capital structure of the subsidiary in order to enable it to continue in business for the purpose of augmenting the petitioner's income. Such a contribution by a stockholder is a capital expenditure, not an ordinary and necessary business expense.

The decision of the Board is affirmed.

[fol. 98] United States Circuit Court of Appeals, Eighth Circuit

INTERSTATE TRANSIT LINES, Petitioner,

VS.

COMMISSIONER OF INTERNAL REVENUE

On Petition to Review Decision of United States Board of Tax Appeals

JUDGMENT-July 31, 1942

This cause came on to be heard on the petition to review the decision of the United States Board of Tax Appeals redetermining that there is a deficiency in the income tax of the petitioner for the calendar year 1936, on the record of the proceedings before the said Board, and was argued by counsel.

On Consideration Whereof, it is now here Ordered and Adjudged by this Court that the order of the said Board of Tax Appeals in this cause be, and the same is hereby, affirmed.

And it is further ordered by this Court that the petition to review in this cause be, and the same is hereby, dismissed without the taxation of costs in favor of either of the parties in this Court.

July 31, 1942.

[fol. 99] IN UNITED STATES CIRCUIT COURT OF APPEALS

[Title omitted]

Petition for Rehearing-Filed August 14, 1942

Now comes the above named petitioner, Interstate Transit Lines, and moves for a rehearing of the above entitled cause for the reasons hereinbelow set forth.

On page 2 of the typewritten opinion in this cause is set out a part of Section 50½ of the California Public Utilities Act, Deering's General Laws of California, 1931, Act 6386 (page 3561), in which it is provided that no passenger stage corporation shall operate or cause to be operated any passenger stage over any public highway in California without first having obtained from the railroad commission a certificate declaring that public convenience and necessity require such operation. No mention is made [fol. 100] of Section 26 of the same Act, which was passed in 1915 and contained the following clause:

"provided, that foreign corporations engaging in commerce with foreign nations or commerce among the several States of this Union may transact within this State such commerce and intrastate commerce of a like character."

Further, whether or not the language just quoted was impliedly repealed by Section 50¼ (passed in 1927), this language was re-enacted in 1935, prior to the taxable year involved in this cause, and was in effect throughout 1936. (See pages 19 and 20 of our original brief herein.)

It follows, therefore, that there is an inaccuracy in the following sentence appearing on page 6 of this court's type-written opinion:

"These things were done to augment the petitioner's income by increasing the income of its subsidiary from revenues derived from the intrastate business in which the petitioner could not engage." (Italics ours.)

The italicized words are incorrect.

Likewise on page 8 of the typewritten opinion appears the following sentence:

"The subsidiary in this case was organized primarily to do a business which the petitioner had no authority to do, and was used to carry on an active business for profit." (Italics ours.)

The italicized words in the above sentence are likewise incorrect.

Plainly, in 1936 the taxpayer did have authority itself to carry on intrastate business in California, so that there was in the fact of Stages' separate existence that year no element of avoidance of the local law. The record shows that there was no advantage of any kind obtained [fol. 101] by taxpayer by reason of the separate corporate entity apart from the transaction of local business, which, when Stages was organized, was probably but a subjective concept of the taxpaver and of the Commission. But however that may have been at the time Stages was organized, there was no such advantage in the taxable year. This is not a case of a taxpayer seeking to avail itself of the advantages of the separate corporate entity without bearing the tax disadvantages. Because the apparent lack of authority to carry on the local business was stressed both by the Board's opinion and that of this court, and because that seems to have had a controlling effect in the result, in each case, petitioner desires to call attention to this inaccuracy, and requests further consideration in the light of the fact that in the taxable year there was no prohibition against the taxpayer's carrying on the local business.

In another respect the opinion is not entirely clear. The opinion quotes (on page 8 of the typewritten opinion) language from the Supreme Court's opinion in Higgins v. Smith, 308 U. S. 473, 60 S. Ct. 355, 80 L. Ed. 406, to the effect that a taxpayer is free to adopt such organization for his affairs as he may choose and "having elected to do some business as a corporation, he must accept the tax disadvantage," and the further language that the Government "may sustain or disregard the effect of the fiction as best serves the purpose of the tax statute." It is not clear from the opinion whether by this language it is intended to hold that in no circumstances may a taxpayer who has himself set up the corporate entity ever disregard

that corporate entity. If it is intended so to hold, this opinion is contrary to United States v. Brager Building & Land Corp., 124 Fed. (2d) 349. It is difficult to see how the doctrine of the disregard of corporate entity can ever be applied at a taxpayer's instance if it is not to be ap-[fol. 102] plied to the present case; and for this reason it is earnestly submitted that the present holding is contrary to the line of authorities, some of which are cited on pages 7 and 8 of the opinion, commencing with Southern Pacific Ry. v. Lowe, 247 U. S. 330, 38 S. Ct. 540, 62 L. Ed. 1142. it is true that some factual differences exist, it is by no means clear from the opinion herein that this Court has distinguished these cases solely upon factual grounds. Rather does the quoted language from Higgins v. Smith, supra suggest that what has actually been held in the present case is that under virtually no circumstances can the corporate entity ever be disregarded at a taxpayer's instance. This conclusion is further suggested by a sentence (on the top of page 9 of the typewritten opinion) reading:

"The corporate entity of the subsidiary cannot be disregarded, nor the 'tax disadvantage' resulting from its organization avoided,"

for which Higgins v. Smith, supra, is cited.

There have been numerous decisions in which at the taxpayer's instance the corporate entity has been disregarded; but cases like the present one, Keystone Mining Co. v. Gray, 120 Fed. (2d) 1, and Superior Coal Co. v. Department of Finance, 337 Ill. 282, 36 N. E. (2d) 354, are, to say the least, difficult to reconcile with the other line of cases of which Southern Pacific Ry. v. Lowe was the forerunner. Whatever the law may be, whether favorable or unfavorable to taxpayers, it is desirable that it be clarified. It is therefore earnestly submitted that this would be an appropriate case for a clear pronouncement on this subject. Whether or not taxpayer is, under the law, entitled to prevail, the facts tending to support disregard of the corporate entity in the present case are [fol. 103] unusually strong, particularly if the inaccuracy with respect to the California law is corrected. While perhaps not as strong a factual case as the Brager Building & Land Corporation case, 124 Fed. (2d) 349, the case at bar is, if anything, stronger for the taxpayer than the

Inland Development Company case, 120 Fed. (2d) 986, and some of the other cases referred to. Because of this, and because of the language used in the opinion, it would seem that this court has held, in this case, that under no circumstances can the corporate entity ever be disregarded at the instance of the taxpayer. Yet, because the opinion is not clear on this point, the already confused state of the law is by the precedent created by the present case, even more confused.

It is submitted therefore that the opinion is incorrect in the important respect relating to the effect of the California law, and also seems in conflict with some of the other cases on the legal question whether under any circumstances the corporate entity may at a taxpayer's instance be disregarded.

For these reasons the taxpayer requests a reconsidera-

tion of this cause.

Respectfully, Joseph F. Mann, Nelson Trottman, Attorneys for Petitioner.

The undersigned Counsel for Interstate Transit Lines, the above named petitioner, hereby certify that the above and foregoing petition is filed in good faith and is believed to be meritorious, and is not filed for the purpose of delay.

Joseph F. Mann, Nelson Trottman.

[File endorsement omitted.]

[fol. 104] IN UNITED STATES CIRCUIT COURT OF APPEALS

Order Denying Petition for a Rehearing—September 8, 1942

The petition of the petitioner for a rehearing of this cause having been considered by this Court, It is now here Ordered by the Court that said petition be, and the same is hereby, denied.

September 8, 1942.

[fol. 105] IN UNITED STATES CIRCUIT COURT OF APPEALS

MOTION FOR STAY OF MANDATE-Filed September 11, 1942

Now comes the above named petitioner and moves for a stay of this Court's mandate for a period of thirty (30) days from and after September 19, 1942, in order to enable petitioner to complete the preparation and filing of its application to the United States Supreme Court for a writ of certiorari to review the decision of this Court in the above entitled cause.

Dated this 9th day of September, 1942.

Joseph F. Mann, Nelson Trottman, Attorneys for Petitioner.

To Hon. Samuel O. Clark, Jr., Assistant Attorney General, Washington, D. C.

Please take notice that the above named petitioner will file with the Clerk of the United States Circuit Court of Appeals for the Eighth Circuit, on September 11, 1942, a motion for a stay of mandate herein for a period of thirty (30) days from and after September 19, 1942, in order to enable petitioner to prepare and file its application to the United States Supreme Court for a writ of certiorari to review the decision of this Court in the above entitled cause.

Dated this 9th day of September, 1942.

Joseph F. Mann, Nelson Trottman, Attorneys for Petitioner.

[fol. 106]

Affidavit of Mailing

STATE OF ILLINOIS, County of Cook, 88:

Jeanne Gates, being first duly sworn, on oath deposes and says that on September 9, 1942, she deposited in the United States Mails, for transmission by air-mail, with air mail postage fully prepaid, addressed to Hon. Samuel O. Clark, Jr., Assistant Attorney General, Washington, D. C., the original of the attached notice, and at the same time also deposited in the mails addressed to the Honorable Samuel O. Clark Jr., a copy of petitioner's motion for stay of mandate, for like transmission by air mail, with air mail postage fully prepaid.

Jeanne Gates.

Subscribed and sworn to before me this 9th day of September, 1942. Margaret C. Carmody, Notary Public. (Seal.)

[File endorsement omitted.]

[fol. 107] IN UNITED STATES CIRCUIT COURT OF APPEALS, SEPTEMBER TERM, 1942

ORDER STAYING ISSUANCE OF MANDATE—September 14, 1942

Monday, September 14, 1942.

On Consideration of the motion of petitioner for a stay of the mandate in this cause pending a petition to the Supreme Court of the United States for a writ of certiorari, It is now here ordered by this Court that the issuance of the mandate herein be, and the same is hereby, stayed for a period of thirty days from and after this date, and if within said period of thirty days there is filed with the Clerk of this Court a certificate of the Clerk of the Supreme Court of the United States that a petition for writ of certiorari, record and brief have been filed, the stay hereby granted shall continue until the final disposition of the case by the Supreme Court.

September 14, 1942.

[fol. 108] IN UNITED STATES CIRCUIT COURT OF APPEALS

MOTION FOR FURTHER STAY OF MANDATE—Filed October 12, 1942

Now comes the above named petitioner and moves for a further stay of this Court's mandate for a period of forty-five (45) days from and after October 19, 1942, in order to enable petitioner to complete the preparation and filing of its application to the United States Supreme Court for a writ of certiorari to review the decision of this Court in the above entitled cause, the reasons for this motion being those stated in the Affidavit of Counsel heretofore attached.

Dated this 8th day of October, 1942.

Joseph F. Mann, Nelson Trottman, Attorneys for Petitioner.

Affidavit

STATE OF ILLINOIS, County of Cook, ss:

Nelson Trottman, being first duly sworn, on oath deposes and says:

1. That he is one of the attorneys for the petitioner in the above entitled cause;

2. That deponent's associate counsel is in New York and that other counsel in the employ of the Interstate Transit Lines, but not formally representing petitioner in this cause, are located in Omaha, Nebraska; that it has not yet been determined finally whether or not an application should be made for a writ of certiorari in this cause; that deponent is obliged to take up with such associate counsel in New [fol. 109] York, and with counsel in Omaha, the question whether or not to apply for such writ; that this would in any event have entailed some delay in coming to a decision because of the distance deponent is from both associate counsel and counsel in Omaha, but that further delay has inevitably resulted by reason of the severe illness of said New York counsel; that said counsel has been confined to his home since about the first of September and deponent is informed and believes, although he is much improved and is now able to be up and around his home, he will not return to his office and be available for conference until well toward the end of the present month:

3. That this Court's petition for rehearing was denied on September 8, 1942, and that under the rules covering the filing with the Supreme Court of petitions for writ of certiorari the time for filing such petition herein will not ex-

pire until December 7, 1942.

4. That in order that a determination can be arrived at after full and mature consideration of the question whether an application for review of this Court's decision should be made to the Supreme Court, the extension requested in this motion is necessary, for the reasons hereinabove set forth, so that if it is determined that such petition be filed it may be filed before the issuance of this Court's mandate.

Nelson Trottman.

Subscribed and sworn to before me this 8th day of October, 1942. Margaret C. Carmody, Notary Public. (Seal.)

[Endorsed:] Filed in U. S. Circuit Court of Appeals, Oct. 9, 1942.

[fol. 110] STATE OF ILLINOIS, County of Cook, 88:

Jean Keilogg, being first duly sworn, on oath deposes and says that on October 8, 1942, she deposited in the United States Mails, with postage prepaid, addressed to Hon. Samuel O. Clark, Jr., Assistant Attorney General, Washington, D. C., the original of the attached notice, and at the same time also deposited in the mails, addressed to said Hon. Samuel O. Clark, Jr., a copy of petitioner's motion for a further stay of mandate, together with affidavit of counsel thereto attached.

Jean Kellogg.

Subscribed and sworn to before me this 8th day of October, A. D. 1942. Margaret C. Carmody, Notary Public. (Seal.)

To: Hon. Samuel O. Clark, Jr., Assistant Attorney General, Washington, D. C.

Please take notice that the above named petitioner will file with the Clerk of the United States Circuit Court of Appeals for the Eighth Circuit, on October 12, 1942, a motion for a further stay of mandate herein for a period of [fol. 111] forty-five (45) days from and after October 19, 1942, in order to enable petitioner to prepare and file its application to the United States Supreme Court for a writ of certiorari to review the decision of this Court in the above entitled cause. A copy of said motion with affivadit of coursel attached thereto is transmitted herewith.

Dated this 8th day of October, 1942.

Joseph F. Mann, Nelson Trottman, Attorneys for Petitioner.

IN UNITED STATES CIRCUIT COURT OF APPEALS

ORDER FURTHER STAYING ISSUANCE OF MANDATE--October 20, 1942

On Consideration of the motion of Petitioner for a further stay of the mandate in this cause for a period of forty-five days from and after October 19, 1942, pending a petition to the Supreme Court of the United States for a writ of certiorari, It is now here ordered by this Court that the issuance of the mandate herein be, and the same is hereby, further stayed for a period of forty-five days from and after October 14, 1942, and if within said period of further stay there is filed with the Clerk of this Court a certificate of the Clerk of the Supreme Court of the United States that

a petition for writ of certiorari, record and brief have been filed, the further stay hereby granted shall continue until the final disposition of the case by the Supreme Court. October 20, 1942.

[fol. 112] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 113] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1942

No. 552

[Title omitted]

ORDER ALLOWING CERTIORARI-Filed March 8, 1943

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Eighth Circuit is granted, and the case is transferred to the summary docket.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

(5175)